

UNITED STATES OF AMERICA

DEPARTMENT OF COMMERCE

INTERNATIONAL TRADE ADMINISTRATION

IMPORT ADMINISTRATION, DEPARTMENT OF COMMERCE

US-CHINA JOINT COMMISSION ON COMMERCE AND

TRADE WORKING GROUP ON STRUCTURAL ISSUES

HEARING

THURSDAY, JUNE 3, 2004

The working group convened the public hearing at 9:00 a.m. in the Department of Commerce auditorium, 1401 Constitution Avenue, NW, Washington, D.C., James J. Jochum, chairperson, presiding.

PANEL MEMBERS PRESENT:

JAMES J. JOCHUM, Chair, Assistant Secretary for Import Administration, U.S. Department of Commerce

SHAUN DONNELLY, Deputy Assistant Secretary for Trade Policy Promotion, Department of State

LARRY GREENWOOD, Department of State

GWYN KOEPKE, Department of Treasury

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

PANEL MEMBERS PRESENT: (CONT.)

JAMES LEONARD, Deputy Assistant Secretary for
Textiles, U.S. Department of Commerce

ARNOLD LEVINE, Deputy Under Secretary for
International Affairs, Department of Labor

DAVID LOEVINGER, Deputy Assistant Secretary for
Africa, Middle East, and Asia, Department of
Treasury

RONALD LORENTZEN, Acting-Director, Office of Policy,
Import Administration, U.S. Department of
Commerce

JEFFREY MAY, Deputy Assistant Secretary, Import
Administration, U.S. Department of Commerce

JOHN McINERY, Chief Counsel for Import Administration,
U.S. Department of Commerce

TERRANCE McCARTIN, Director of Monitoring and
Enforcement for China, Office of the United
States Trade Representative

BETSY WHITE, U.S. Department of Labor

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

I N D E X

Opening Remarks, James J. Jochum, Assistant Secretary for Import Administration	4
Remarks by Interagency Panel Members	8
Remarks to the Panel by The Honorable Philip English, 3rd District Pennsylvania	8
<u>Testimony:</u>	
Terrance Stewart, Stewart & Stewart	22
Remarks by Mr. Dai Yunlou, Minister Counselor, Embassy of China	40
<u>Testimony:</u>	
Bill Klinefelter, United Steelworkers of America	44
Steve Araba, King & Spalding, LLP	61
Robert Cassidy and David A. Hartquist, Collier Shannon Scott, PLLC	85
Jeffrey Gerrish, Skadden, Arps, Slate, Meaghan & Flom, LLP	136
Hugh Rushing, Cookware Manufacturers Association	147
Anne Rublowski, American Forest and Paper Association	161
Elizabeth Drake, AFL-CIO	172
Adjourn	193

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

P R O C E E D I N G S

9:12 A.M.

1
2
3 MR. JOCHUM: Good morning. Can everyone
4 hear me?

5 I'd like to welcome everyone to this
6 public hearing to receive input from interested
7 parties that will assist the Structural Working Group
8 as it seeks to gain a detailed understanding of the
9 operation of China's economy.

10 I would especially like to thank everyone
11 joining us in person today and those who submitted
12 comments in response to the Federal Register notice.
13 I realize that the comment period was unusually short,
14 so we appreciate the hard work that went into
15 developing the useful and constructive comments we
16 received.

17 I want to extend a special welcome to my
18 interagency colleagues and thank them for taking the
19 time to participate in today's hearing.

20 In April of this year, the U.S-China Joint

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Commission on Commerce and Trade established a Working
2 Group to examine the structural reforms being
3 undertaken in China's economy and to identify the
4 additional reforms that will need to be taken to
5 address the nonmarket-base practices and policies that
6 continue to give rise to trade distortions between our
7 two countries. Through the work of this group, we
8 expect to improve our mutual ability to address the
9 root causes of bilateral trade frictions.

10 The immediate task of the Structural
11 Working Group and the purpose of this hearing is to
12 identify issues for further discussion and analysis.
13 These issues would likely include the structure and
14 operation of China's economy; the Chinese government's
15 role in the economy, particularly in the banking
16 sector and other state-owned enterprises; the Chinese
17 labor market and Chinese current practices; and those
18 additional government policies and practices that have
19 the potential to distort trade and impede market
20 activity.

21 I was pleased that the written comments
22 addressed all of these issues and more. We look

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 forward to hearing your perspective on these topics in
2 greater detail today.

3 Before proceeding, however, it's important
4 that I clarify the role of the Structural Working
5 Group and indeed this hearing itself. Neither this
6 hearing nor the Structural Working Group constitute a
7 review of China's nonmarket economy status under U.S.
8 anti-dumping law. Under China's WTO accession
9 protocol, the United States and other WTO members are
10 allowed to treat China as a nonmarket economy for
11 purposes of the anti-dumping laws through the year
12 2016.

13 Any decision to graduate China to market
14 economy status, whenever that decision is made, must
15 be made in the context of a formal, quasi-judicial
16 proceeding in accordance with Section 771,
17 subparagraph 18(b) of the Tariff Act of 1930, as
18 amended, and would be based solely on facts in
19 evidence placed on the administrative record of such
20 proceeding.

21 As in previous proceedings undertaken
22 pursuant to this statute, the record would be

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 developed from data and information gathered from
2 expert third party sources such as the OECD and World
3 Bank, as well as from comments received from
4 interested parties and the public.

5 Today's hearing is designed to gather
6 information in order to inform and guide the work of
7 the Structural Working Group. While at this time we
8 do not expect to hold additional hearings as part of
9 the Structural Working Group process, our door is
10 always open for your continued comment and input.

11 In terms of how we will proceed this
12 morning, I would remind witnesses and panelists that
13 while this is a public hearing, it's not intended to
14 be a debate. Each witness will be given 10 minutes to
15 present their issues to the panel and panelists will
16 then be afforded a brief opportunity ask questions
17 they may have for the witness.

18 All presentations will be on the record
19 and made available to the public. We will post a copy
20 of the hearing transcript on the Department of
21 Commerce website, however, a written transcript may be
22 obtained directly from the reporting service.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 The panel before you today includes
2 officials from the Departments of Commerce, State,
3 Treasury and Labor and the Office of the U.S. Trade
4 Representative. We are also honored by the presence
5 of a distinguished Member of the House of
6 Representatives, Congressman Phil English of
7 Pennsylvania who will make a statement for the record.

8 Because we have quite a few witnesses
9 asking to be heard, I would like to stay on schedule
10 as much as possible in order to give everyone their
11 full opportunity speak, so I'd ask the witnesses to
12 please respect the time keeper.

13 Again, thank you all for coming today. I
14 would now invite my interagency colleagues to say a
15 few words of introduction, after which the Honorable
16 Phil English will be recognized to begin the
17 proceeding.

18 I think I'll start to my left, Deputy
19 Assistant Secretary Jim Leonard who heads up our
20 Textile Office at the Department of Commerce.

21 MR. LEONARD: Thank you, Mr. Chairman, for
22 the opportunity to be on the panel today. Even though

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 there is no participant today from the textile or
2 apparel industry, textiles and apparel are certainly a
3 sensitive area for the U.S. economy. China is
4 becoming a major player in the textile and apparel
5 industry and when quotas go away at the end of this
6 year, it's expected that China will even become a
7 bigger player in this sector. So it's important for
8 me in my responsibility relative to textiles, apparel
9 and consumer goods to hear what some of the
10 participants today say because certainly some of those
11 will apply to the statements that we hear from the
12 textile and apparel industry. So I'm looking forward
13 to hear what participants have to say today and
14 participate in this hearing.

15 Thank you.

16 MR. JOCHUM: Thanks, Jim. Mr. Shaun
17 Donnelly, who is the Deputy Assistant Secretary of
18 State for Trade Policy Promotion.

19 Shaun?

20 MR. DONNELLY: Jim, thank you. We
21 appreciate very much being included on this panel
22 today. The State Department is a member of the Trade

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 Policy Staff Committee, Trade Policy Review Group
2 Process and we have a broad interest in all the
3 economic issues relating to China.

4 I focus on the economic and trade issues
5 at the State Department, but my colleagues in the East
6 Asia Bureau, the Democracy, Labor, Human Rights Bureau
7 have a broad interest in many of the issues in the
8 human rights and labor issue that are also an
9 important part of our overall agenda with China. So
10 we're very pleased to be with you today.

11 MR. JOCHUM: Thank you, Shaun. David
12 Loevinger, who is the Deputy Assistant Secretary of
13 Treasury for Africa, Middle East and Asia.

14 David?

15 MR. LOEVINGER: Thank you. Like Shaun,
16 Treasury also is heavily engaged on a range of trade
17 issues with China, working very closely with Commerce
18 and USTR.

19 I personally have been most involved with
20 Treasury's efforts over say the last year, year and a
21 half, to get China to move to a more market-based,
22 more flexible exchange rate regime. This really

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 started with Secretary Snow's visit to Beijing in
2 September and we have a lot going on. We recently
3 named a special envoy, Ambassador Paul Spelts to work
4 with the Chinese, as well as U.S. businesses, in
5 getting them to open up not only on the exchange rate,
6 but on a range of financial sector issues.

7 I was in China just a few months ago to
8 launch what we call our technical cooperation program
9 which to help them with the regulatory and financial
10 tools they need to manage greater exchange rate
11 flexibility.

12 Thanks.

13 MR. JOCHUM: Thanks, David. And Mr.
14 Arnold Levine, the Deputy Under Secretary of Labor for
15 International Affairs.

16 MR. LEVINE: Thank you and good morning.
17 We, too, at the Department of Labor are pleased to be
18 participating in today's hearing and the on-going
19 activities to improve our everyday relationships with
20 China. We are actively engaged in China today and
21 look forward to further cooperation in the future.
22 Thank you.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 MR. JOCHUM: Thanks, Arnold.

2 Mr. English, again, we're very pleased
3 that you could take the time to join us today and
4 please proceed with your statement.

5 CONGRESSMAN ENGLISH: Good morning,
6 Chairman Jochum and members of the Working Group.
7 It's a real privilege to be with you here today and I
8 wish you well in your deliberations.

9 For the record, I represent the 3rd
10 Congressional District of Pennsylvania and I'm pleased
11 to offer the perspective of someone who has been a
12 critic of China trade to your evaluation.

13 I've watched with great interest the
14 meeting of the JCCT which formed this group and the
15 preparation which ensued for today's meeting,
16 including the submission of testimony by a number of
17 domestic and overseas interests.

18 The issue of the evolution of China in the
19 global marketplace is of the utmost important, not
20 only to domestic manufacturers and farmers, but to
21 those same interests in every other country in the
22 world. The sheer magnitude of the Chinese population

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 and the ability of China to effect many facets of the
2 global economy through that scale will keep the
3 world's eyes fixated on China's commitment to become a
4 responsible player in the international trading
5 community.

6 I would very much like to impress upon
7 this Working Group, Mr. Chairman, that if for no other
8 reason China's importance to the global trading
9 community now and in the future is a paramount reason
10 that the Department of Commerce should not evaluate
11 whether to graduate China lightly or expeditiously.
12 The statutory requirements laid out in the Tariff Act
13 of 1930 must be thoroughly and carefully considered.
14 From my perspective, and I think that and many others
15 in Congress, China simply is not ready at the present
16 time to graduate to market economy status for the
17 purposes of the U.S. anti-dumping law. That is not to
18 suggest, however, that China has not made some
19 progress in certain relevant areas.

20 I believe that much of the progress to
21 date has been the result of continued engagement with
22 Beijing by the United States and particularly by this

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Administration.

2 This strategy, in my view, is the correct
3 one and we cannot now revert to isolationism when
4 dealing with the challenges facing domestic interest
5 as a result of China's evolving economy, but with
6 engagement comes certain responsibilities. Congress
7 and especially the Ways and Means Committee which I
8 serve on, has a special responsibility to provide
9 oversight on this process as it moves forward.

10 While Congress may have designated the
11 Department of Commerce as the administering authority
12 for purpose of determining which countries are to be
13 nonmarket economies under the Tariff Act of 1930, it
14 certainly did not make the statutory criteria for
15 making such a determination available as bargaining
16 chips in a negotiation between the Administration and
17 Beijing.

18 Frequent consultation with Congress, as
19 this process moves forward, would, in my view, go a
20 long way to ensure a smooth transition of market
21 economy status over whatever period it may take.
22 Continued public participation is also absolutely

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 essential if the Department of Commerce is to fully
2 understand the perspective of domestic interests which
3 have experienced China's economy first hand or are
4 currently operating in China.

5 This is also true if we are to fully
6 convey to China what the statute requires of the
7 Chinese economy before the Department of Commerce is
8 able to graduate China to market economy status.

9 Let me point out as in past agreements
10 with China, I do not believe that Congress is willing
11 to tolerate the promise of future reforms or
12 alternatively, worthless laws which are not enforced
13 as real change.

14 Changes in the economy and practices of
15 the Chinese government must occur before market
16 economy status may be granted. Many commitments were
17 made as part of China's accession agreement to the WTO
18 and as a Member of the Ways and Means Committee at the
19 time, I was part of that process. Many of those same
20 commitments remain completely unfulfilled.

21 All of these shortcomings are relevant to
22 the Department of Commerce's proceedings on this

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 matter, whether it is continued use of discriminatory
2 tax regimes, control of the banking sector into
3 subsidized core heavy industries such as steel,
4 licensing and quota regimes, or export restraints like
5 the one currently in place on coke and coke and coal.

6 These practices all represent commitments which the
7 Chinese have not fulfilled to our satisfaction.

8 Evidence also strongly suggests the same
9 unsatisfactory results when it comes to certain labor
10 standards. These issues need to be sufficiently
11 addressed in order to meet the criteria needed for
12 graduation to market economy status and must be fully
13 explored by this panel.

14 Mr. Chairman, I'd like to particularly
15 emphasize one aspect of China's economy for the panel.

16 As you know, the first criteria of the statute is
17 "the extent to which the currency of the foreign
18 country is convertible under the currency of other
19 countries."

20 I would submit to this panel that the
21 practice of currency manipulation for trade advantage
22 which China currently maintains does not achieve a

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 passing grade in the context of this criterion. Far
2 from it. It is widely accepted that the Chinese
3 currency is substantially undervalued against the
4 dollar to which it is pegged. China's currency has
5 been pegged at about 8.3 Yuan to the dollar since the
6 system was implemented in 1994. China has been able
7 successfully to maintain this peg because its currency
8 is not fully convertible in international markets and
9 because it maintains restrictions and controls over
10 capital transactions. As a consequence, manufacturers
11 in my District face competition from Chinese products
12 that come in at pricing below the cost of imputes. As
13 a result, China's exchange rate is not based on market
14 forces. Many economists have acknowledged that
15 China's currency is significantly undervalued relative
16 to the dollar, making Chinese's exports to the United
17 States cheaper and U.S. exports to China more
18 expensive than they would be if exchange rates were
19 determined by market forces.

20 Many of my colleagues in Congress agree.
21 In response to China's reluctance to address this
22 egregious trade imbalance, I've introduced H.R. 3058.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 This legislation in a nutshell would impose a tariff
2 on all Chinese imports to the United States in an
3 amount equal to the undervaluation of the Yuan.
4 Eighty-five Members of the House of Representatives
5 have co-sponsored this legislation.

6 One final point I would like to make to
7 the panel is not directly to the Department's
8 consideration of whether or not to graduate China to a
9 market economy, but it is in my opinion a fundamental
10 flaw in the administration of U.S. trade remedy law.

11 China is not the first economy to request
12 to graduate to market economy status and certainly it
13 will not be the last. While I believe we must
14 continue to work with nonmarket economy countries to
15 foster reform, I also believe that our manufacturers
16 and farmers should have complete access to the full
17 range of U.S. trade remedy laws while we wait for
18 nonmarket economies to choose when, and indeed if, to
19 make the reforms necessary to graduate to market
20 economy status. This includes the U.S. countervailing
21 duty law.

22 As many of you know, since 1980, the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Department of Commerce has declined to hear
2 countervailing duty cases against nonmarket economies
3 including China because it claimed that the Tariff Act
4 of 1930 did not require them to do so. So in effect,
5 U.S. producers cannot fight illegal Chinese and other
6 nonmarket economy subsidized products until China
7 chooses to change its economy and the Department of
8 Commerce grants China market economy status.

9 In my view, this is absolutely
10 unacceptable, particularly so at a time when our
11 manufacturers are facing a serious domestic crisis.
12 That is why I, along with Representative Artur Davis,
13 have introduced H.R. 3716, legislation which currently
14 has the support of over 50 Members of the House and
15 would simply require the Department of Commerce to
16 hear countervailing duty cases against nonmarket
17 economy countries.

18 H.R. 3716 does not change any other aspect
19 of CBD law, including the statutory requirements by
20 which the Department of Commerce evaluates the merit
21 of the case. I am hopeful that the Administration
22 will evaluate this legislation and consider supporting

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 it.

2 CBD cases against NMEs are not a strange
3 or impossible concept. This type of trade remedy is
4 fully consistent with our WTO obligations and should
5 apply to both nonmarket economies, as well as market
6 economies.

7 Thank you for your patience, Mr. Chairman,
8 and I welcome any questions from the panel.

9 MR. JOCHUM: Thank you, Mr. English.
10 Again, I want to thank you for taking the time to be
11 with us. I thought you made a very thoughtful and
12 constructive statement and laid out of issues that
13 we're going to have really grapple with over the
14 coming months and maybe years.

15 I do take your point about consulting with
16 Congress as someone who has spent half his career as a
17 Senate staffer, I think I realize the importance of
18 working with Congress on an issue of this importance,
19 so I can commit to you today that we will continue to
20 do that and our door is always open to you and your
21 staff, if you have questions or input into this
22 process, but we will work very closely with you on

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 this as we go along.

2 CONGRESSMAN ENGLISH: We're very grateful
3 for the opportunity to provide input and I think we'll
4 be hearing from more of my colleagues as this progress
5 progresses.

6 MR. JOCHUM: Very good.

7 CONGRESSMAN ENGLISH: I thank all of you
8 for the chance to appear.

9 MR. JOCHUM: Thanks very much. We
10 appreciate it.

11 Now I need to go back to introductions
12 because I was remiss in missing one of our
13 distinguished panelists. On the political spectrum
14 I'm not known for just looking to my left and ignoring
15 my right, but in this case, that's exactly what I did
16 and I missed Mr. Terry McCartin, who is the Director
17 of Monitoring Enforcement for China for the Office of
18 the U.S. Trade Representative. So at this time, I'd
19 like to thank Terry for joining us and recognizing him
20 for any opening statement he may want to make.

21 Thanks, Terry.

22 MR. McCARTIN: Thank you, Jim. I would

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 just like to thank the parties for their detailed
2 submissions. I think despite the short notice, many
3 important issues were raised regarding the nature and
4 workings of China's economy. Two issues I would
5 highlight are the Chinese currency practices and
6 China's labor practices.

7 We look forward to our discussions with
8 the Chinese government on all of these issues. Thank
9 you.

10 MR. JOCHUM: Next on our witness list is
11 Mr. Dai who is the Minister Counsel for the Embassy of
12 China and I don't know if Mr. Dai is here, but if
13 you're here, Mr. Dai, please come up to the front.

14 I'm wondering if we could
15 recognize Mr. Terry Stewart. Is Terry with us?
16 Terry, can you jump up one in the order?

17 MR. STEWART: Good morning. It's a
18 pleasure to be here. My name is Terrance Stewart.
19 I'm the managing partner of Stewart & Stewart, a law
20 firm here in town. We have been involved before this
21 Agency on trade remedy matters for many years,
22 including cases involving the People's Republic of

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 China.

2 The question presented today is given
3 China's interest in achieving market economy status
4 for purposes of U.S. anti-dumping law, and given the
5 establishment of this working group, to address that
6 aspiration, what issues should be taken up that
7 reflect distortions in the Chinese economy that should
8 be addressed prior to China's being treated as a
9 market economy under U.S. law.

10 The paper that we presented identifies 11
11 categories of issues, as well as some suggested
12 benchmarks that the U.S. should use to gauge whether
13 China has achieved sufficient progress in its reforms
14 to be considered a market economy under U.S. law.

15 While China has undertaken significant
16 reforms as part of its efforts to join the WTO and in
17 more recent years, to comply with its obligations,
18 there remain many distortions within the Chinese
19 economy which result in trade flows or the lack of
20 trade flows that are not in keeping with the
21 functioning of the market economy. Because of China's
22 importance to the global trading system, and the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 unprecedented bilateral trade deficit that the U.S.
2 has with China, it is important that the full array of
3 distortions be addressed prior to China's being
4 accorded market economy status. Maintaining such a
5 position is in the interest, not only of the United
6 States, but also of those interests within China that
7 are promoting economic reform.

8 Let me turn then to the statutory criteria
9 as a starting point for the identification of issues.

10 As you're aware, Section 19 U.S.C. 1677, paragraph 18
11 identifies five specific factors and a sixth catch-all
12 provision that the Department must consider in
13 analyzing whether a country should be classified as an
14 nonmarket economy. Currency, in terms of whether it's
15 convertible; wage rates, in terms of whether they
16 result from free bargaining between labor and
17 management, joint ventures and other investment
18 measures, whether they're permitted and to what
19 extent, the extent of government control or ownership
20 of the means of production; the extent to which the
21 government controls the allocation of resources and
22 price and output decisions of enterprises; and the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 basket category, other factors that the Department
2 considers appropriate.

3 In my written comments, we address 11
4 factors, many of which are critical to many businesses
5 in the United States and we believe are all critical
6 to a classification of a country as a market economy.

7 Our paper suggests benchmarks that should be applied
8 for each factor. The list that we have is not
9 intended to be exhaustive but is, in our view, a
10 minimum list of factors and benchmarks that should be
11 established by the United States government.

12 The remainder of my remarks today I'll
13 focus on some broader topics and then provide a short
14 summary of our recommendations.

15 First, in this exercise, it's important to
16 remember that the United States negotiated the right
17 to apply and China agreed to the application of the
18 NME methodology for 15 years after its accession into
19 the WTO. Considering the transition periods that
20 China sought and obtained on a variety of WTO
21 commitments and the likely difficulties that China has
22 had and will have in bringing its system into full

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 compliance with WTO accession commitments, the 15-year
2 period was a recognition of the likelihood that
3 China's economy would continue to have significant
4 distortions for an extended period of time after
5 accession; hence, warranting a different approach to
6 how Chinese goods are handled under U.S. trade remedy
7 laws.

8 While the U.S. may choose to apply its NME
9 methodology to China beyond the 15-year period, if
10 warranted under U.S. law, China has agreed that the
11 U.S. has a right to continue to treat China as an NME
12 and to apply the NME methodology until December 11,
13 2016, subject only to national law requirements in the
14 U.S. Stated differently, if China desires a speed up
15 in its treatment as a market economy under U.S. law,
16 it is China's burden to make the economic reforms that
17 would warrant a different treatment.

18 Second, in considering what would be
19 needed for China to obtain a change in status under
20 U.S. law, the U.S. should require the achievement
21 market economy reforms that are reflective of the size
22 and importance of China's economy and the global

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 trading system. Thus, we believe that the Department
2 should use benchmarks that compare China's economic
3 and market reforms to the operation of other major
4 trading nations, in particular, OECD countries. This
5 is an appropriate benchmark given China's influential
6 position in world trade.

7 Third, the Department should examine all
8 aspects of the Chinese economy that distort the
9 internal market and/or that distort trade flows from
10 the U.S. to China from China to the U.S. and in third
11 markets. If one uses those standards of evaluation,
12 we believe there are at least 11 issues that must be
13 addressed. A summary of those issues was contained on
14 pages 17 and 18 of our written comments.

15 In summary, the issues and benchmarks are
16 condensed to 10, as follows: first, respecting
17 currency convertibility. The Department should
18 examine whether China has dismantled its currency
19 exchange controls and has established a freely
20 floating currency. Minimally, China's currency should
21 be realistically valued so as to approximate its
22 underlying value vis-a-vis the United States dollar.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Second, regarding wages, whether wages are
2 freely bargained, the Department should examine
3 whether China has fully implemented the ILO's core
4 labor standards, in particular, the rights of freedom
5 of association and collective bargaining.

6 Three, regarding joint ventures and other
7 investment measures, the Department should review
8 whether China has fully implemented its WTO trading
9 rights obligations, whether China's restrictions on
10 foreign investments are comparable to those in the
11 United States and other OECD countries, whether China
12 continues directly or indirectly to require technology
13 transfers as a de facto condition for investing in
14 China, and whether China has fully complied with its
15 obligations under the terms of the agreement.

16 Fourth, regarding government ownership or
17 control of the means of production, as well as control
18 over the allocation of resources and over the price
19 and output decisions of enterprises, the Department
20 should examine whether the level of central,
21 provincial and local government ownership or control
22 is at or below the average for OECD countries.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 Fifth, regarding intellectual property
2 rights, the Department should review whether China's
3 enforcement efforts have reduced the level of IP
4 piracy to that equivalent to or below the level for
5 OECD countries, as well as whether there are effective
6 means in place to enforce claims against other forms
7 of IP lawsuits.

8 Sixth, regarding trading rights and price
9 controls, the Department should determine whether
10 China has eliminated state trading and designated
11 trading for all goods.

12 Seventh, China's banking sector, the
13 Department should review whether Chinese banks operate
14 on commercial principles such as whether loans are
15 based on commercial considerations reflecting actual
16 risk and whether the level of bad debts in China is
17 equivalent to or below the average for OECD countries.

18 Eighth, regarding subsidies, the
19 Department should examine whether China has complied
20 with its WTO subsidy obligations as reflected in the
21 SCM agreement, its protocol of accession and its
22 working party report and in particular, whether China

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 has eliminated export subsidies and phased out
2 subsidies to state-owned enterprises operating at a
3 loss.

4 Ninth, regarding state owned and state-
5 invested enterprises, the Department should review
6 whether the level of China's SOEs and SIEs matches or
7 is below the average for OECD countries.

8 Finally, regarding discrimination against
9 foreign goods such as the VAT, a discrimination on
10 semi-conductors, the Department should examine whether
11 China has eliminated all forms of discrimination
12 against foreign goods that are inconsistent with WTO
13 obligations.

14 Thank you for the opportunity to appear
15 today and express my views.

16 MR. JOCHUM: Thank you, Terry, and for
17 those of us who are familiar with your work, it's
18 always very comprehensive and thought-provoking and I
19 think you've met that standard again today, so I
20 appreciate it.

21 I'm interested in the choice of the OECD
22 countries as a benchmark and I think that's a useful

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 tool. I'm wondering what the Department has done in
2 the past, if you're familiar with previous graduations
3 and how we've made that comparison and whether we use
4 sort of all the other countries that have been
5 previously graduated to market economy status, whether
6 we used some subset of that or whether -- what
7 benchmark at all did we use in those proceedings?

8 MR. STEWART: Off the top of my head, Mr.
9 Chairman, I wouldn't give you a response to that.
10 What I would say is that since the request from China
11 has been tell us what it is we need to do and what the
12 standards are, that these are reasonable standards in
13 light of the economic importance that China has
14 assumed.

15 As you stated in your opening comments,
16 should China at some point wish to have a formal
17 review by the Commerce Department, it is entitled to
18 do that and you will do it on the record, based upon
19 the submissions that are made.

20 But considering the size and importance of
21 the Chinese economy to suggest to them that a level of
22 state control greater than that of other major trading

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 partners in the world would be deemed a reasonable
2 benchmark does not take into account the distortions
3 that exist. One could use the U.S. as the standard,
4 but in fairness there, we have major trading partners
5 who do have state-owned enterprises, state-invested
6 enterprises to a significant extent. And using those
7 as comparisons seems to me is a fair middle ground.

8 MR. JOCHUM: I'd invite the panelists to
9 ask any questions.

10 Shaun?

11 MR. DONNELLY: Thank you. Mr. Stewart, in
12 your submission, you talk about the Chinese not fully
13 enforcing some of the laws they already have on the
14 books. Do you have any suggestions of what the
15 international community or the U.S., in particular,
16 might do, in general, to try and encourage that
17 process?

18 MR. STEWART: Thank you for the question.
19 You know, we have done two reports for the U.S.-China
20 Commission that have looked at China's efforts to
21 bring itself into compliance with the obligations that
22 it undertook as part of its accession. And I believe

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 that the Administration, both this Administration and
2 prior Administrations, have believed that rule of law
3 in China was a process and was not something that
4 would happen quickly. If you look at intellectual
5 property, the history of intellectual property
6 agreements, I think we're now approaching 20 years of
7 agreements with China and if you were to ask American
8 industry how things have gone they would say that
9 there has been incremental improvements in that area.

10 So on some areas, it's not clear because
11 you're talking about cultural changes. You're talking
12 about major institutional changes and those are
13 changes that will, I believe, come as they have come
14 to date slowly and only with time.

15 In fairness to the Chinese government, I
16 think those who have watched it have been impressed in
17 the recent years with the amount of effort that has
18 been made to try to reach out and get the education
19 level going down to the various levels that are needed
20 to start the process, but it will not be a quick
21 journey and I don't know that there's much more that
22 you can do with what you have been doing. I thought

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 that what Homeland Security and Customs have been
2 doing over the years in terms of working in the
3 country and trying to help educate Customs enforcement
4 for border issues is an important aspect. I think all
5 of the technical assistance that governments around
6 the world have provided China is very important to
7 China's achieving the status it wishes to achieve.

8 My comments are intended to say China is
9 obviously a very important trading partner for the
10 United States. We have a right to a balanced bargain
11 and the comments in areas where change is needed don't
12 suggest that they haven't made efforts to move
13 forward. It's simply an indication that it's a long
14 road and a broad road, something that I believe many
15 in the government understand.

16 MR. LOEVINGER: Thank you, Mr. Stewart,
17 and I appreciate the comments you made. I had two
18 questions. One was on an issue that both you and
19 Congressman English raised about currency
20 convertibility and country's exchange rate regime and
21 as you mentioned, the law about nonmarket economy
22 status talks about the convertibility of a country's

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 currency.

2 And there are many countries in the world
3 that have completely convertible currencies, but have
4 a fixed exchange rate regime and even though, as I
5 said, we have been pushing China very hard to move to
6 a more flexible exchange rate regime, it would be
7 interesting, very important for us to hear your views
8 on how you think nonmarket economy status should
9 relate to these two somewhat separate things. And
10 just to give the example of Hong Kong, Hong Kong has
11 probably one of these most open economies in the world
12 and certainly the Hong Kong dollar is freely
13 convertible into any other currency, yet they have a
14 pegged exchange rate.

15 MR. STEWART: Fairness of disclosure, our
16 firm has been serving as co-counsel to the Fair
17 Currency Alliance on its concerns about the currency
18 and I think if you look historically, many nations
19 have quote unquote had pegged currencies and you have
20 had periodic revaluations or devaluations when there
21 has been dislocation. In, I believe, recent history,
22 there has been no country that has bought up as much

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 foreign currency to maintain the peg as China has
2 done. And to the extent that economists differ over
3 the extent, there is almost no difference that the
4 currency is seriously undervalued. Since this is
5 happening by state action, it is a pretty classic
6 example, I believe of what the statute was concerned
7 about, namely a government interfering with the
8 operation of market forces to advantage of
9 disadvantage certain parts of the economy or certain
10 parts of global trade.

11 To the extent that there is a belief that
12 you have undervaluation that may be as high as 40
13 percent and there have been some numbers that suggest
14 higher than that, it would go a long way to explain
15 the pretty systemic undervaluation, not simply of U.S.
16 goods, but of goods around the world in sector after
17 sector. The textile and apparel sector, for example,
18 the information that has been put forward by many
19 textile companies is that prices out of China are 30
20 percent below anyone in the world.

21 It is always possible that you can be a
22 super start in certain sectors, but if you were to

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 take a look at U.S. import statistics over the last
2 five, seven years, what you would find is that China
3 has rewritten the rules of economics, if that is the
4 case, because they seem to be under the world in
5 almost every product category by 15, 20, 30 and 40
6 percent. Many of us believe that that's due to an
7 undervaluation of currency. This is not a situation
8 where it's been pegged and when forces put enormous
9 pressure on the country to move that there's been a
10 revaluation. Those of us who have been working with
11 the FCA certainly believe that a serious revaluation
12 of the currency would take a lot of pressure off of
13 the system, both within China from an inflationary
14 point of view and in terms of the operations. So we
15 think it is totally consistent with an examination of
16 what are the issues that need to be addressed and I
17 think that that's why you will probably hear that
18 issue raised by a lot of folks today.

19 MR. JOCHUM: Thanks, David. Arnold?

20 MR. LEVINE: You mentioned as one of your
21 benchmarks the extent to which China is in compliance
22 or has implemented the ILO's core labor standards,

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 especially mentioning freedom of association and
2 collective bargaining. Do you believe it would be a
3 sufficient condition for China to sign on to the
4 various conventions to meet the standard of having
5 wages freely set or is there some other standard you
6 would apply? And also would you comment on the
7 relevance of the other core labor standards which
8 don't deal with freedom of association and collective
9 bargaining and whether those are truly measures that
10 should be applied in this instance.

11 MR. STEWART: Thank you for the question.

12 In our paper, I think probably the largest section of
13 the paper is devoted to labor issues and labor
14 concerns. And I believe that the concern that was
15 expressed by Congressman English as to whether China
16 has adopted laws which, it's my understanding they
17 have adopted laws in a number of the labor standards
18 area, is not the test. The test is whether or not the
19 system is operating where people, in fact, have the
20 opportunity to bargain for their wages, join unions,
21 if they wish to join them, be free from forced labor
22 and the other criteria that are typically recognized.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 In our paper, we cite largely from the
2 State Department 2003 report which documents
3 significant areas that are perhaps not unusual in
4 developing countries, but developing countries, by and
5 large, are economic juggernauts like China. And if
6 one is looking at whether that causes distortion which
7 was my understanding of the issues that you're looking
8 to do, then insuring that all major factors of
9 production are operating in market economy context are
10 important. So we believe that the test has to be how
11 the labor rights are, in fact, operating within the
12 country. The AFL-CIO filed a 301 petition on labor
13 right concerns that documented a host of issues, many
14 of which are supported by what has been in the State
15 Department report. The fact that the case wasn't
16 initiated, at least from the statements that were made
17 at the press conference, indicated that it wasn't that
18 there wasn't a recognition that there are serious
19 labor issues, but that there are other ways that the
20 U.S. was hoping to move that particular issue forward.

21 So we believe all of the issues in the
22 core labor standards are important and that the test

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 isn't whether laws are on the books because there are
2 laws on the books in many of the areas. It's really a
3 question of State Department type of analysis, are
4 meaningful labor rights, in fact, being enjoyed; human
5 rights being enjoyed.

6 MR. JOCHUM: Terry, I think you bore the
7 brunt of being our second witness, but I appreciate
8 your responsiveness. It was very helpful to us.
9 Thanks.

10 Now I'd like to recognize Mr. Dai. Mr.
11 Dai, the Ministry Counselor of Economics for the
12 Embassy of China who would like to present a statement
13 on behalf of the government of China.

14 Mr. Dai, thanks very much for joining us
15 today.

16 MR. DAI: Sorry to be late. It was
17 because of traffic. I think that the Chinese
18 government has provided the written comments to the
19 Commerce Department. Today, I just want to deal with
20 some points. My remarks won't be long.

21 The government of the People's Republic of
22 China appreciates this opportunity to make a

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 presentation in this public proceeding of the U.S.
2 Department of Commerce. We welcome this opportunity
3 to speak to you why we believe it is time for the
4 United States to change its designation of China as
5 nonmarket economy and to recognize China as market
6 economy.

7 Now I just would like to clarify some
8 points with regard to China's WTO accession agreement.

9 Some probably have heard that the U.S. government
10 should treat China as a nonmarket economy for a full
11 15 years because they believe that this is what China
12 agreed to. However, that is not what China's WTO
13 accession agreement requires. Indeed, the agreement
14 specifically provides that countries such as the
15 United States are required to stop treating China as a
16 nonmarket economy once China establishes a market
17 economy without waiting until the end of 15 years.

18 The 15-year period is a maximum, not
19 minimum. The fact is that China has changed and it
20 has changed a lot. Indeed, since China became a WTO
21 member, countries such as New Zealand, Singapore and
22 Malaysia have recognized China's market economy

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 status.

2 Secondly, we would like to clarify the
3 issue that we suggest should be addressed in
4 considering China's market economy status. As WTO
5 members, both China and the United States are
6 committed to a rule-based system of trade and dispute
7 resolution. Within this system, anti-dumping duties
8 are exceptions to the general trading rules. These
9 exceptions exist solely to provide a remedy for export
10 price distortions. They are not meant to punish.

11 For market economy countries and fairly
12 low export pricing is remedied through anti-dumping
13 proceedings, using whole market prices at the primary
14 benchmark. In contrast, for countries designated as
15 nonmarket economy countries, anti-dumping measures is
16 not based on whole market sales, but based upon a
17 surrogate country analysis. This methodology
18 introduces its own price distortions and can create
19 unfair and unrealistic results. Whether China should
20 be treated as a market economy or as a nonmarket
21 economy is really an issue of which methodology would
22 be the fairest way in pricing any unfair export

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 pricing.

2 In this connection, China observes that
3 governments worldwide intervene in their economies.
4 Governments in market economy countries provide trade
5 distorting subsidies, controlled interest rates, own
6 production and trading companies, controlled natural
7 resources, intervening in foreign exchange markets and
8 imposed currency controls, regulated conditions of
9 competition and even set prices for setting goals and
10 services.

11 Therefore, the question of whether a
12 country is a market economy necessarily is a question
13 of a degree and not absolutes. The United States, I'm
14 sure, recognizes in its six factor market economy
15 test.

16 China believes that the distortions exist
17 in all economies, therefore in assessing whether the
18 Chinese economy is a market economy, the central
19 question is not something whether distortions exist,
20 but rather whether the nonmarket economy anti-dumping
21 methodology is better suited to remedying the alleged
22 distortion.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Finally, I would like to highlight some of
2 the numerous market economy changes that have occurred
3 in China. China's economy today is very different
4 from the centrally planned economy of decades ago.
5 China's economic reform started in 1978. In 1992,
6 China set the goal to establish a market economy. In
7 2002, China proclaimed to the world that it has
8 established a preliminary system of market economy.
9 Since China became a WTO member, people have witnessed
10 a lot of new developments which include constitutional
11 recognition and protection of property rights,
12 dramatic restructuring, reorganization and reduction
13 of state-owned enterprises, rising dominance of the
14 private sector in the Chinese economy, and further
15 opening up to foreign investment.

16 The world has witnessed the astounding
17 transformation in China's economy. China is now an
18 important stakeholder in the global treaty system.
19 This growth stems from the opening of the economy to
20 private enterprises and market forces. China is now
21 the world's third largest importer and the fourth
22 largest exporter.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 In light of these developments, the
2 Chinese economy is operating on the basis of market
3 principles towards sufficient extent that its domestic
4 process and costs should be used as a basis for
5 calculating normal value in U.S. anti-dumping
6 proceedings.

7 The Chinese government looks forward to
8 discussions with the United States on the issue of
9 revoking China's current nonmarket economy status and
10 recognizing China as a market economy for purposes of
11 U.S. trade laws.

12 In closing, I want to emphasize that
13 treating China as a market economy, not only benefits
14 China, but also benefits the United States. Imports
15 from China benefit U.S. consumers and U.S. industries
16 and help create jobs in the United States. Additional
17 duties that are imposed unfairly in imports from China
18 hurt significant U.S. interests.

19 So China welcomes this process. It
20 represents the beginning of China-U.S. discussions on
21 this important issue. We hope that this process will
22 move forward and lead to the recognition of China as a

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 market economy.

2 Thank you for your attention.

3 MR. JOCHUM: Thank you, Mr. Dai, for your
4 presentation on behalf of the government of China. I
5 know we'll have a lot of opportunity to talk in the
6 future and as you know, part of our group will be
7 coming out to China in July for the first meeting,
8 bilateral meeting of the Structural Working Group, so
9 we appreciate your help in facilitating that process
10 and we'll be in touch. Thanks a lot.

11 We move down the agenda. I now would like
12 to recognize representatives on behalf of the United
13 Steelworkers of America. I think I see our old
14 friend, Bill Klinefelter here. Bill, thanks for
15 joining us.

16 MR. KLINEFELTER: Good morning, Chairman
17 Jochum, members of the Working Group. My name is Bill
18 Klinefelter. I'm the legislative and political
19 director of the Steelworkers Union and it's a pleasure
20 to be here to offer this testimony in regards to China
21 and its status as a nonmarket economy. We're the
22 union representing workers producing a variety of

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 steel and other products that face competition from
2 Chinese imports, some of which have been the subject
3 of anti-dumping procedures.

4 The USWA has a strong interest in the
5 topic before the U.S.-China JTCC Working Group on
6 structural issues, that is, what issues are relevant
7 to a consideration of China's aspirations to be
8 recognized as a market economy country for the purpose
9 of U.S. anti-dumping laws. The Department notice
10 stated that the focus on such issues as structural
11 characteristics of the Chinese economy that appear to
12 be inconsistent with the normal experience of a market
13 economy, as well as Chinese government policies and
14 practices which have potential to distort the market
15 in U.S.-China trade.

16 My written comments and my testimony today
17 focus on two aspects of the Chinese economy and
18 government policies that are not consistent with
19 market economies and have made market distortion
20 effects: the status of labor rights in China and
21 Chinese subsidies.

22 First, however, I'd like to note it's

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 important to keep in mind that the nonmarket economy
2 methodology that is used in anti-dumping procedures
3 involving China is a right that the United States
4 negotiated as part of China's accession to the WTO.
5 Because China has admitted to the WTO before it can
6 fully comply with all WTO obligations, the United
7 States negotiated the right to continue to apply NME
8 methodology in anti-dumping procedures for 15 years
9 following China's accession or until December 11,
10 2016.

11 As China agreed to this condition, the
12 right should not be lightly dismissed. To that
13 extent, China is able to clearly demonstrate the
14 market condition prevailing economy and then it can
15 satisfy U.S. law criteria for market economy, China
16 may request the NME methodology cease to apply.
17 However, it is incumbent upon China to put forward the
18 evidence that supports any change in China's status as
19 an NME and as one who lobbied extensively on China
20 PNTR, I believe that there are tremendous amount of
21 Members in the Congress of the United States who
22 agreed to China PNTR simply because of this and the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 assurances that it gave them that China would be
2 treated as a nonmarket economy for 15 years. And I
3 believe extensively on the Hill, whether it's rightly
4 or wrongly, there is a strong belief that that was
5 what the intention of what they were voting on was to
6 be.

7 Regards to labor fights in China, the
8 statute defining a nonmarket economy country sets out
9 six factors that the Department must consider. The
10 second of these concerns are the wage rates that are
11 determined by free bargaining between labor and
12 management. On this point alone, China would fail the
13 test of consideration as a market economy country.
14 Indeed, China's record with respect to allowing free
15 collective bargaining between labor and management is
16 woeful. Moreover, China's denial of labor rights has
17 a distorted effect on U.S.-China trade. By giving
18 China-based producers an unfair cost advantage,
19 China's failure to provide core labor rights
20 ultimately results in the loss of U.S. manufacturing
21 jobs.

22 As a member of the ILO, China is bound to

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 respect, promote and realize ILO core labor standards,
2 including conventions on freedom of association and
3 collective bargaining. China's failure to respect,
4 promote and realize these rights is well documented.
5 The recent Section 301 petition filed by the AFL-CIO
6 concerning China's labor practice provides a cogent
7 evidence that China does not meet the standards of
8 free bargaining that are common to market economy
9 countries. In particular, petition notes that the PRC
10 uses all organs of state power, the Communist Party,
11 the People's Liberation Army, the People's Armed
12 Police and the Public Security Bureau, the political
13 police, the Labor Department -- not ours -- and the
14 State Structural Procurial and Penal Systems to
15 suppress workers' rights of associations, rights of
16 collective bargaining and the right to strike. In
17 other words, the entire system as we used to
18 experience in the communist system in the Soviet Union
19 and the Eastern European countries, the entire focus
20 of the state is to prevent and eliminate the formation
21 of free labor unions and the exercise of free
22 collective bargaining.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Thus, factory workers in China are wholly
2 denied the fundamental rights of association and
3 collective bargaining by law and practice. Similar
4 conclusions regarding China's denial of the rights of
5 free association and collective bargaining have been
6 voiced by, among others, the Congressional Executive
7 Commission on China in their annual reports and in the
8 Department of State's Annual Country Reports.

9 In regards to subsidies, in addition to
10 the five enumerating factors, the NME statute provides
11 the Department to consider other relevant factors as
12 appropriate. Among these others factors, we believe
13 that the Department should include in consideration of
14 China's compliance with its WTO obligation respecting
15 subsidies and the degree to which China subsidized its
16 domestic industries; these factors, particularly where
17 Chinese government policies and practices are
18 distorting the market and U.S.-China trade.

19 In the accession protocol China agreed to
20 eliminate all export and import substitution subsidies
21 as well as to phase out subsidies provided to certain
22 state-owned enterprises running at a loss. China also

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 committed to notify all subsidies in accordance with
2 the WTO subsidies agreement. China has not fully
3 complied with these commitments. China has yet to
4 submit any subsidy notification required under WTO
5 agreement. Thus, we don't know whether China has
6 eliminated all export-import substitution subsidies or
7 subsidies operating at a loss. However, USTR has
8 expressed doubt. In its annual report to Congress
9 regarding China's WTO compliance, the USTR has noted
10 the U.S. industries believe that China continues to
11 use export subsidies for agricultural products,
12 especially corn and cotton, as well as for a range of
13 industrial products including high tech electronics,
14 textiles and steel.

15 Moreover, as the WTO's second transitional
16 review mechanism concluded in December 2003, China
17 acknowledged it provides export contingent tax relief
18 to foreign investors and with respect to subsidies
19 provided to SOEs operating at a loss, the U.S. raised
20 concerns at the second TRM that China had not phased
21 out these subsidies as it committed to do. Subsidies
22 caused market distortions. China's steel industry

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 which is now the world's largest has as in the past,
2 receives and continues today to receive government
3 subsidies, government-support subsidies. China has
4 subsidized the steel industry through various
5 measures, including government-planned investment,
6 loan forgiveness and debt for equity swaps.

7 In its July 2000 Global Steel Study, the
8 Department of Commerce reported that the Chinese
9 government's allocation and use of investment funds
10 were based in large part on nonmarket signals. Such
11 government subsidies which are not based on commercial
12 considerations distort the market conditions and U.S.-
13 China trade by encouraging expanded capacity in over
14 production leading to price instability and dumping.
15 Any consideration of China's aspirations to market
16 economy status must address the market distortions
17 caused by the Chinese government's subsidies to the
18 steel industry to other industries and to SOEs
19 operating as a loss.

20 As Chairman Jochum and staff are well
21 aware, we are deeply engaged in subsidy negotiations
22 at the OECD. And as they are also aware, the union

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 and the industry, but the union and in particular, I
2 will speak for us, we are deeply concerned about the
3 future of global steel and global capacity issues. We
4 believe that this little flux that we're going through
5 now is a brief and temporary stage of prosperity for
6 the American steel industry.

7 The 201 that the Administration granted
8 did give the industry a period of time in which to
9 consolidate and that consolidation has gone forward at
10 a fairly rapid pace and has helped the American steel
11 industry, but we view China as looming on the horizon
12 as the largest producer of steel, the largest importer
13 of steel, the largest consumer of steel inputs and
14 wonder, wonder, what the global steel situation will
15 be a year, two years from now if those rapid rates of
16 growth that China has experienced in the 9 to 10
17 percent, depending on who you talk about, begin to
18 slide and they come down to a mere 5 percent growth
19 rate. Where will that steel go? What will the United
20 States be able to do about it? And so from the
21 union's perspective, all defense mechanisms that we
22 can have in place to preserve and protect the American

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 steelworker jobs, that's what ask of you. I thank
2 you.

3 MR. JOCHUM: Thank you, Mr. Klinefelter.
4 Questions from the panel?

5 Mr. Levine?

6 MR. LEVINE: Thank you for your statement.
7 I appreciate it. I think we all would acknowledge
8 that there have been great changes in the Chinese
9 economy over recent years, including, for example, the
10 spinoff of many state-owned enterprises.

11 Are you aware of any sectors or lines of
12 business where something approaching freely negotiated
13 wage rates might exist?

14 MR. KLINEFELTER: Would you just repeat
15 that again, I didn't quite get what you meant?

16 MR. LEVINE: With all the -- your
17 statement presents pretty much as a monolithic case
18 that there is no free setting of wages in China. I'm
19 just wondering whether in light of all the economic
20 change and change in the business that has taken
21 place, whether there are certain pockets, perhaps now
22 in some of these new industries, these spun off

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 industries from the state-owned enterprises, where
2 there are these vestiges of freely negotiated wages?

3 MR. KLINEFELTER: I'm not aware that there
4 is any areas, or pockets, of free association or free
5 collective bargaining as we know it here in the United
6 States or in Western Europe. I will look into it, but
7 I'm quite sure and I will ask the AFL-CIO to comment
8 on it as well. I have never heard that there is in
9 any respect, any free association allowed in China and
10 thus, without free association, you can't have free
11 collective bargaining.

12 MR. JOCHUM: Mr. Donnelly?

13 MR. DONNELLY: Thanks, Mr. Klinefelter.
14 Could you speculate and I guess it is a speculation,
15 if we had free association and free collective
16 bargaining in China, what impact that would be likely
17 to have on wage rates in China which are obviously
18 low? Thanks.

19 MR. KLINEFELTER: I think that many people
20 look at when the American labor movement talks about
21 whether people should have free association and free
22 collective bargaining as another methodology for us

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 imposing protectionism, it is not. We believe that if
2 we can raise all the boats in the world, then the
3 world will be a better place and that trade will then
4 be free and equitable because as the Chinese people
5 grow and progress in their income -- I saw some
6 figures the other day and I found these figures to be
7 alarming. By the year 2050 China will be the biggest
8 economy in the world by these estimates, but also
9 included in those estimates, the Chinese per capita
10 income in 2050 would be \$10,000. Well, \$10,000 is not
11 the kind of person who goes out and buys the goods and
12 services that is provided by the United States and
13 other developed countries. And so I think that what
14 we're saying is in order to get China to the point
15 where it is a truly developed country, a truly free
16 market, it must have those mechanisms that are
17 included and part of that is collective bargaining
18 which will over time raise the rates. I mean if you
19 go back, these are all historical trends. If you go
20 back in the history of the United States when the
21 American labor movement started in the 1930s what were
22 the wages in the basic steel industry then? I mean

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 they were dollars per week. But if you look at now, a
2 steelworker is a middle class job here in the United
3 States. And what labor's intent is is to have middle
4 class jobs throughout the world so that we have
5 markets for American goods and so that we have a
6 rising standard of living for all people and an
7 equitable distribution of the wealth of the planet.

8 MR. JOCHUM: Mr. Klinefelter, I just have
9 a quick question. Obviously, you know, we share your
10 concerns on global subsidies in the steel industry and
11 I really appreciate the close working relationship
12 we've had with the union on that issue. Some have
13 suggested this morning that we now take a big step and
14 start applying our CBD law to nonmarket economies such
15 as China. And obviously, if we were to do that at
16 some point under our CBD law we have to make specific
17 findings of subsidies. We have to tie it to exports.
18 We have to find that it's specific to an industry
19 instead of more broadly available.

20 I'm wondering if you point out a number of
21 subsidies and obviously we agree that China has failed
22 to make the notifications required under the WTO, but

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 we would have to get much more in-depth information to
2 actually pursue a CBD case and I'm wondering if you
3 have any of that information or I'm sure you don't
4 today as it would have been in your testimony, I
5 guess. I'll seek a pledge to work closely with you,
6 if and when we get to that point, but that would be a
7 very practical obstacle to us, proceeding on that
8 front at this point in time. So I would just say
9 we'll have to work with you and others on that.

10 MR. KLINEFELTER: And as always, we would
11 be more than happy to be working with you and with
12 counsel that we have in regards to these matters that
13 you know so well.

14 MR. JOCHUM: Thanks, Bill. I think we
15 have one question from Jim Leonard.

16 MR. LEONARD: Jim Leonard with Office of
17 Textiles. We work very closely with both the Embassy,
18 Mr. Dai's office here as well as the Chinese
19 government and the Chinese industry to do all the
20 kinds of things that we're talking about in terms of
21 the Chinese textile industry which is significant.

22 I think we all agree that certainly China

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 is making progress, albeit very slow. They make
2 significant comments to us about the level of the
3 state-owned enterprises and how they've gone from the
4 50 percent down to 5 or 10 percent. And yet, when we
5 talk to individual company representatives, they
6 declare that they are a private company, we own 51
7 percent and the state owns 49 percent. So it gets
8 into a definitional issue of state-owned versus
9 private-owned facility.

10 I wonder if you have that -- if you know
11 of that same sort of situation that exists in the
12 steel industry, where they really will say, you know,
13 we're moving away from the state-owned enterprises to
14 more private, and yet the state is still a significant
15 participant.

16 MR. KLINEFELTER: Yes, I think that those
17 similar circumstances exist in the Chinese steel
18 industry and I can't remember the exact figure, but
19 there are many more steel companies in China than you
20 would ever think. There are lots of steel and Mr.
21 Jochum can probably address that, the number, the
22 exact number, but it's really amazing. While we've

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 gone through and the Europeans have gone through a
2 tremendous period of consolidation, the Chinese
3 industry is so diffuse and diverse that I think that
4 they even have a hard time getting a handle on what's
5 being built and created in terms of capacity in China.

6 China, you know, when you look at China,
7 it's sort of like 19th century America. I mean if
8 they have Jay Gould, I wouldn't be surprised because
9 it's unfettered growth. It goes on and on. And there
10 are very few controls.

11 MR. JOCHUM: Further questions? Bill,
12 thanks a lot for your testimony. I appreciate it.

13 MR. KLINEFELTER: Thank you.

14 MR. JOCHUM: Next on the docket is the law
15 firm of King and Spalding. I appreciate the witnesses
16 showing up early because we're making quick progress
17 this morning and hopefully we will not run out of an
18 agenda before we run out of time. Thanks for joining
19 us today.

20 MR. ARABA: Thank you, Mr. Chairman. My
21 name is Steve Araba. I'm a partner at King and
22 Spalding and I am appearing here today on behalf of

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 the American Furniture Manufacturers Committee for
2 Legal Trade.

3 The Committee is an ad hoc coalition
4 comprised of over 30 U.S. producers of wooden bedroom
5 furniture and together with five labor unions is the
6 Petitioner in the pending anti-dumping investigation
7 of wooden bedroom furniture from China.

8 I would like to thank the Department for
9 this opportunity to testify on an issue of critical
10 importance to the U.S. manufacturing sector,
11 generally, and to the U.S. furniture industry, in
12 particular.

13 Rather than reiterate our comments
14 submitted to the Department last month, I would simply
15 like to highlight a few important aspects that are
16 critical to initiating any dialogue regarding China's
17 nonmarket economy status.

18 As we all know, the United States
19 successfully negotiated as part of China's WTO
20 accession process the right to apply nonmarket economy
21 methodology in anti-dumping proceedings involving
22 imports from China until 2016. This right is

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 available to the United States unless China
2 demonstrates under U.S. law that it complies with the
3 statutory criteria justifying graduation to market
4 economy status. This transition period was considered
5 critical to securing passage in Congress of
6 legislation to implement both China's accession and
7 other provisions of the U.S.-China bilateral
8 agreement.

9 USTR and Members of Congress cited this
10 transition period as a basis for securing the post-
11 accession interests of the U.S. manufacturing
12 industry. The United States should not truncate this
13 15-year period and undermine the bargain reached in
14 the U.S. Congress, especially without a comprehensive
15 examination of the Chinese economy and a clear
16 demonstration that China has met its burden of proof
17 on all relevant statutory criteria.

18 One key to any evaluation of the Chinese
19 economy, whether as a whole or on a sectoral basis, is
20 transparency and access to information. Without
21 verifiable information and evidence covering
22 structural characteristics and government policies and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 practices at the national, provincial and local level,
2 no meaningful dialogue regarding China's graduation to
3 market economy status is possible. Moreover, without
4 such information in evidence, China simply cannot
5 satisfy its burden under U.S. law.

6 China has demonstrated an unwillingness or
7 inability to be open and transparent by failing to
8 comply with even its general notification obligations
9 under the WTO. According to USTR's 2004 Foreign Trade
10 Barrier Report, for example, China has failed to make
11 the required subsidy notifications since becoming a
12 member of the WTO. In the context of the WTO's
13 transitional review mechanism, USTR again found that
14 China did not provide information that would "allow a
15 meaningful assessment of China's compliance efforts."

16 The information required pursuant to these
17 WTO obligations, even assuming full compliance is just
18 the tip of the iceberg regarding the depth and breadth
19 of the information and evidence needed to demonstrate
20 that China should be considered a market economy. The
21 full extent of the transparency problems was
22 highlighted even further by USTR in the area of export

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 subsidies. According to USTR's 2004 report, it is
2 difficult to identify and quantify possible export
3 subsidies in China because of the lack of transparency
4 in China's subsidy regime. Chinese subsidies are
5 often the result of internal administrative measures
6 and are not publicized.

7 At a minimum, the Department should
8 require that China publicize its national, provincial
9 and local subsidy regimes as a condition for any
10 future dialogue on its market economy status. Under
11 U.S. law, a nonmarket economy is any foreign country
12 that the Department determines does not operate on
13 market principles of cost or pricing structures, so
14 that sales and merchandise in such country do not
15 reflect the fair value of the merchandise. The
16 statute also requires the Department to consider six
17 factors that have been reviewed repeatedly up here.

18 In determining whether a country is a
19 nonmarket economy, under the general standard and the
20 six factors, China has not made available necessary
21 information to permit any meaningful dialogue. And
22 information that is available clearly shows that China

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 cannot qualify for market economy status under U.S.
2 law. Generally, the Chinese government maintains an
3 active role in promoting its industries and its
4 economic development is currently managed through 2005
5 by the government's tenth five-year plan. More
6 specifically, China's economy does not operate on
7 market principles because of the presence of extensive
8 government incentives and industry promotion policies,
9 discriminatory tax practices and anti-competitive
10 practices.

11 For example, state monopolies in the
12 energy sector enable Chinese national, provincial and
13 local governments to offer low cost infrastructure
14 services to attract investments and to support plant
15 expansion. Moreover, available information shows that
16 provincial and local governments are avidly pursuing
17 export subsidies in order to develop and expand
18 export-oriented industries.

19 Additional information regarding certain
20 export subsidy programs and the massive subsidies
21 provided in the form of payments to state-owned banks
22 for nonperforming loans can be found in our written

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 comments.

2 Notably, USTR reported to Congress in 2003
3 that U.S. government subsidy experts are seeking more
4 information from China and are investigating
5 substantiation practices in the textiles, steel,
6 petrochemical, machinery and copper and other
7 nonferrous metals industries. We would urge the
8 Department to add the furniture industry to this list
9 of industries, subject to such investigations and to
10 share the findings and methodologies of these
11 investigations with U.S. industry.

12 As detailed in our written comments, the
13 Chinese furniture industry has clearly benefitted from
14 the government's direct role in developing the
15 production assets of the light industry along the
16 Chinese coast in order to facilitate exports. A
17 report issued jointly by U.S. and Chinese
18 universities, for example, identifies a wide range of
19 government incentives in the furniture industry, such
20 as export-oriented policies and support for plant
21 expansion. Incentives and other market-distorting
22 policies aimed at small and medium sized enterprises

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 are also relevant to the furniture industry because
2 the majority of producers are small enterprises.

3 The U.S. Department of State's fiscal year
4 2004 Country Commercial Guide for China provides
5 another assessment of how China's economy fails to
6 operate under market principles required for market
7 economy status under U.S. law. The guide states that
8 China continues to struggle with economic
9 inefficiencies and investment disincentives created by
10 local protectionism, predatory pricing, preservation
11 of industry-wide monopolies and monopolistic practices
12 designed to protect the state-owned sector.

13 In certain areas, industrial conglomerates
14 operating as monopolies or near monopolies such as
15 China Telecom have been authorized to fix prices,
16 allocate contracts and in other ways restrict
17 competition among domestic and foreign suppliers.
18 Regional protectionism by provincial or local
19 authorities tends to restrict market opportunities for
20 foreign invested enterprises in China.

21 When evaluating the six specific factors
22 under U.S. law, it is evident that China's economy

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 lacks the features of a market economy. The six
2 factors include the convertibility of local currency,
3 the extent to which wage rates are determined by free
4 bargaining, the extent to which foreign investments
5 are permitted, the extent of government ownership or
6 control of the means of production, the extent of
7 government control over price and output decisions of
8 enterprises and other factors the Department should
9 consider.

10 In our written comments, we provided a
11 series of factual information relating to these
12 factors, not necessarily meaning to pigeon hole any of
13 that information under any of these factors and much
14 of the information discussed earlier today relates to
15 those factors in more detail.

16 What we would like to say is that first
17 relating to the conversion of Chinese currency, it is
18 still subject to strict controls. Companies in need
19 of foreign exchange must apply to designated banks and
20 individuals can only obtain foreign currencies up to
21 certain amounts for a limited number of purposes
22 specified under Chinese law. Further details of these

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 currency restrictions are available in our written
2 comments.

3 Second, labor costs in China are severely
4 distorted due to the lack of labor rights protection
5 in China and the absence of free bargaining between
6 labor and management. In its 2004, Foreign Trade
7 Barrier Report, USTR expressly found that "China does
8 not adhere to certain internationally recognized labor
9 standards, such as the right to freely associate or
10 bargain collectively." In addition, the Congressional
11 Executive Commission on China found that Chinese
12 government forbids its citizens from forming
13 independent trade unions which prevents Chinese
14 workers from defending their own interests in terms of
15 wages, working hours and work place health and safety
16 conditions. The Commission also found that with
17 respect to worker rights, China is frequently in
18 violation of its own laws, especially those governing
19 wages and overtime pay, work hours, overtime hours and
20 work place health and safety.

21 Wage rates are distorted further by
22 government management of labor flows through the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 operation of the residency registration system. As a
2 result of these practices, average labor costs in
3 China is reportedly only 5 percent of the cost in
4 developed countries like the United States, Japan and
5 Germany. These distortions in terms of wage rates and
6 other costs of labor clearly benefit labor intensive
7 and export oriented industries such as the furniture
8 industry.

9 Third, regarding investment, despite the
10 fact that China has attracted a massive amount of
11 foreign direct investment, significant barriers to
12 investment still exist. According to USTR, they not
13 only include general barriers such as opaque and
14 inconsistently enforced laws and regulations, but also
15 strict sectorial restrictions on foreign investment,
16 especially in the sectors not in line with the needs
17 of China's national economic development. According
18 to U.S. companies, factors such as export performance
19 and local content are still considered by government
20 officials in deciding whether to approve an investment
21 or to recommend approval of a loan from a Chinese
22 bank.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 In addition, as stated by USTR, foreign
2 investment enterprises in China remain largely unable
3 to access domestic and international stock markets, to
4 sell corporate bonds, to accept venture capital
5 investment, to sell equity and to engage in normal
6 merger acquisition and divestment activity. Foreign
7 exchange transactions on the capital count can be
8 concluded only with case by case official review and
9 approvals are subject to very tight regulatory
10 control. These barriers to capital market access are
11 not removed by China's WTO accession agreement.

12 As noted previously, regional
13 protectionism at the provincial and local level also
14 severely restricts the activities of foreign
15 investment entities and joint ventures.

16 Fourth, the Chinese government continues
17 to own or control essential means of production such
18 as land use, access to capital markets and
19 transportation through government restrictions or
20 through state-owned or controlled enterprises. In
21 addition, the U.S. Department of Energy reported only
22 a year ago that the Chinese government controls

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 virtually all aspects of the energy industry,
2 including the ownership or control of oil and natural
3 gas reserves and those companies exploiting such
4 reserves.

5 In the furniture industry, lumber is the
6 main raw material for making furniture and timber
7 rights largely dictate the cost of lumber. The
8 Chinese government's ownership and control over the
9 allocation of pricing of timber rights seriously
10 distorts costs and pricing of furniture in China. The
11 Working Group should thoroughly investigate the
12 significant distortions to the Chinese economy and to
13 the furniture industry caused by these circumstances.

14 Fifth, with regard to government control
15 on price and output decisions of enterprises, USTR
16 found that China maintains price controls on several
17 products and services covering both state-owned
18 enterprises and private enterprises. The price law of
19 China, for example, shows that Chinese government
20 exerts influence over private entities pricing
21 behavior by adjusting and controlling the price level
22 of a commodity it deems important. Based on the price

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 law for example, the Shanghai Furniture Industry
2 Association issued a rule on pricing behavior in the
3 furniture business. This set a ceiling on profits for
4 private furniture producers that limits their ability
5 to price their products freely.

6 Finally, other factors also indicate that
7 China cannot be considered a market economy, including
8 the presence of a significant number of state-owned
9 enterprises in the economy, the continued existence of
10 state trading enterprises, and the state-owned Chinese
11 banking sector. Estimates regarding the number of
12 state-owned companies and their impact on the economy
13 vary. The U.S. Department of State reported that
14 traditional state-owned enterprises amounted to
15 approximately 42 percent of gross industrial output.
16 In 2001, China's National Statistics Bureau reported
17 that over 30 percent of enterprises were still state
18 owned and a further 22.8 percent were collectively
19 owned.

20 In the furniture industry, a recent study
21 of 72 Chinese furniture companies found that state-
22 owned companies accounted for 47 percent of the sales

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 by those companies. The existence of these companies,
2 as well as the significant number of state-owned
3 enterprises in the various input sectors for the
4 furniture industry creates substantial distortions in
5 the market.

6 Mr. Chairman, as you mentioned in your
7 opening remarks, we are also concerned about the
8 extremely short time period and length restrictions
9 for submitting comments on these complex issues. We
10 trust that the current round of comments and testimony
11 is not part of any U.S. strategy to expedite the
12 unwarranted granting of market economy status to
13 China, but rather is tendered simply to identify a
14 range of general matters on which preliminary dialogue
15 with Chinese officials could be based. We look
16 forward to future opportunities to participate in this
17 important dialogue.

18 In sum, available information regarding
19 the structural characteristics of the Chinese economy
20 and prevailing national, regional and local government
21 policies and practices demonstrate that China does not
22 meet the statutory criteria under U.S. law to qualify

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 as a market economy. China's failure to make
2 available sufficient information on each of the
3 relevant factors prevents the U.S. government and
4 affected U.S. industries from engaging in anything
5 more than general dialogue. Mere statements that
6 China is a market economy are simply not sufficient
7 under U.S. law.

8 Prior to any serious consideration of
9 China's nonmarket economy status, the United States
10 needs comprehensive and verifiable evidence covering
11 all relevant aspects of China's economy. Without
12 this, the United States cannot conduct the necessary
13 review under U.S. law and cannot and should not
14 prematurely grant China market economy status before
15 2016.

16 Thank you, Mr. Chairman.

17 MR. JOCHUM: Thank you, Araba. You raise
18 a number of important issues as does the dumping case
19 we have before us on wooden bedroom furniture which I
20 believe is the largest dumping case in terms of value
21 ever conducted by the Department on Chinese imports.

22 Since you raised it, I'll take the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 opportunity to clarify my opening statement again on
2 the issue of whether this constitutes a review of
3 China's nonmarket economy status and reiterate for
4 those who were not here previously that this hearing
5 and this structural written group process by no means
6 represents that review which will be undertaken at
7 some point in time, perhaps, when a petition is filed
8 of China's market economy status and at that time
9 parties would have the full opportunity to make
10 comment to the Department as in previous reviews under
11 the statute. So thanks for raising that again and
12 allowing me to clarify that.

13 I think we do have some questions from the
14 panel for you, if you wouldn't mind.

15 Jeff May?

16 MR. MAY: I'm the Deputy Assistant
17 Secretary for Enforcement. My responsibilities
18 include the conduct of anti-dumping and countervailing
19 matters under Mr. Jochum.

20 I really want to thank you for the
21 submission that you made and particularly the amount
22 of detail that you were able to go into on the range

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 of issues. That's very helpful to our work.

2 The question I have is sort of a broader
3 one emanating from one of the key points you spent
4 some time on in your submission relating to subsidies.

5 The question I have is the place that you see that
6 subsidy issue having in the work of the Structural
7 Working Group as it goes forward, more specifically,
8 do you see it particularly as a trade issue, a concern
9 about the role that subsidies may play in the Chinese
10 economy in terms of supporting exports and affecting
11 trade or are you going further in arguing that it's
12 also -- it also has an integral connection to their
13 status as a nonmarket economy in terms of the views
14 that you express in your submission. I take note of
15 the earlier comments of Mr. Stewart relating to
16 benchmarking issues as we look at them. And on this
17 particular one, certainly there are economies that
18 have subsidies in them that would constitute market
19 economies so I guess if you're arguing there's a
20 connection to the status of the Chinese economy, I'd
21 like to understand sort of how you see it fitting into
22 that benchmarking context and is it a matter of degree

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 in terms of subsidization in the Chinese economy that
2 you're pointing to or is it something about the nature
3 of the subsidies that you see as relating to their
4 status?

5 MR. ARABA: Well, thank you for the
6 question. Obviously, it's a very broad question. I
7 think -- I guess the main point that we would like to
8 make is that we cannot be sure because the ability to
9 identify relevant subsidies, not just at the national,
10 but also more importantly, on the provincial and local
11 level is sort of hamstringing our ability to determine
12 whether it is trade effectual, whether it is something
13 that is fundamentally distorting the market.

14 As far as the furniture industry is
15 concerned, the export subsidies that we suspect are
16 being given not just for the furniture industry, but
17 also almost more relevant to the relevant inputs into
18 the furniture industry, are such that it's difficult
19 to determine the exact level of distortions in the
20 market so from our perspective as U.S. manufacturers,
21 we're extremely concerned about the effects of those
22 subsidies within the -- as a result of imports of some

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 of those relevant products. For purposes of this
2 nonmarket economy review or discussion, I think it's
3 imperative to look at those subsidies and in
4 particular gather information on those subsidies to
5 determine whether those are having an effect and
6 whether the general standards set out in the statute
7 as far as market principles are being observed.

8 I think from our perspective, we don't
9 know enough to really provide a detailed response to
10 that question, but we would certainly like to have the
11 information to make that evaluation for ourselves.

12 MR. JOCHUM: Thanks, Mr. Araba. Further
13 questions?

14 Sure, Terry?

15 MR. McCARTIN: Mr. Araba, you discuss
16 various forms of government subsidization that distort
17 trade with China. One of the them is the provision of
18 land use rights at little or no cost.

19 I just have two questions about that.
20 First, what level of government controls the granting
21 and allocating of land use rights in China? And the
22 second one is a broader question. How would you

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 compare China's system of granting and allocating land
2 use rights to the typical market economy system of
3 direct private ownership of land?

4 MR. ARABA: Well, in response to your
5 first question, I think I'm not really able off the
6 top of my head to give you a detailed response as to
7 the control of land use rights. Our experience is
8 that they are controlled in various ways by local,
9 provincial and national government depending on the
10 circumstances. We can certainly provide you some more
11 information on that at a later date.

12 Could you repeat your second question,
13 please?

14 MR. McCARTIN: The second one, I was just
15 asking you to compare China's system of granting and
16 allocating land use rights to what you typically find
17 in the market economy, whether it's direct, private
18 ownership of land.

19 MR. ARABA: It's difficult to compare. I
20 think what our biggest concern from the furniture
21 industry perspective is the wholesale creation of
22 zones that are not necessarily comparable to what you

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 see in market economies. They are designed and
2 intended to facilitate the creation of industries, the
3 building of plants to specifically target an export
4 market and as a result of that they're able to
5 structure a land use rights regime that allows them to
6 treat certain industries that they want to focus as
7 far as exports much more favorably than they would
8 treat other industries or even sectors, subsectors of
9 particular industries.

10 MR. JOCHUM: Mr. Lorentzen?

11 MR. LORENTZEN: Thank you. My name is Ron
12 Lorentzen and I'm Acting Director of the Office of
13 Policy here at the Import Administration and just to
14 complement the questions that Jeff and Terry asked, I
15 was very impressed by the broad range of issues and
16 distorting practices that you identified in your
17 submission. And I guess one of the things that we've
18 been trying to sort through in our own minds in
19 preparing for the work of this group is to keep in
20 mind that it's first and foremost a process of
21 understanding all of the issues, both through the
22 collection of this information and in organizing

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 ourselves for the meetings with the Chinese
2 government.

3 And if it's possible for you to do it
4 today, I was wondering if you could in any sense
5 prioritize the top three or so area that you think
6 would deserve the greatest attention at the beginning
7 stages of this process, both from the perspective of
8 understanding the structure of the Chinese economy and
9 with respect to looking at what's apt to be the most
10 distortive among the practices that you described?

11 MR. ARABA: Well, provided you don't hold
12 me to it, I think -- rather than give you the top
13 three, I guess I would give you the top two and those
14 have been addressed in much greater detail today
15 already. One is the labor costs, the impact of
16 various wage and labor issues that the gentleman from
17 the AFL-CIO addressed. Those have a significant
18 distorting effect on the furniture industry, for
19 example, because it is a labor intensive industry.
20 That, in and of itself, would be enough to deny any
21 market economy status for the foreseeable future, so
22 it would see that that would be an area to at least

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 ensure that sufficient information was gathered and
2 the relevant analysis is done.

3 The other is on the currency issues.
4 Those are extremely complex and we have yet to grapple
5 with the full effects of those, but it is a situation
6 where it's having a significant impact on U.S.
7 manufacturing and on the U.S. furniture industry.
8 Again, how to grapple with those particular issues,
9 moving forward, I think it's going to be a large task.

10 MR. JOCHUM: Any further questions? Okay,
11 thank you, Mr. Araba, appreciate it.

12 MR. ARABA: Thank you.

13 MR. JOCHUM: I think we're going to forget
14 ahead, even though we're ahead of schedule. We now
15 have a block reserved for the law firm of Collier
16 Shannon Scott and I think I see representatives here
17 and they will be testifying on behalf of several
18 interests and hopefully they can identify the order
19 that they will proceed, once they arrive.

20 MR. HARTQUIST: Good morning, gentlemen.
21 I'm David A. Hartquist of Collier Shannon Scott. And
22 Bob Cassidy is going to lead with our testimony this

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 morning on behalf of a wide range of our clients that
2 have issues relating to China and I will follow up
3 with a mercifully brief statement as the Executive
4 Director of the Committee to Support U.S. Trade Laws.

5 MR. CASSIDY: Thank you, Mr. Chairman.
6 Good morning. My name is Robert Cassidy and I'm the
7 Director of International Trade and Services with the
8 law firm of Collier Shannon Scott. By way of
9 introduction and background, I served as the Assistant
10 U.S. Trade Representative for China during the 1997-
11 2000 period and headed the U.S. negotiating team
12 responsible for negotiating the 1999 Market Access
13 Agreement with China.

14 That agreement set the terms of China's
15 protocol regarding China's status as a nonmarket
16 economy country. Today, I'm appearing on behalf of a
17 number of companies and industries that are vitally
18 interested in the issue of the Commerce Department's
19 identified and defined Federal Register notice. And
20 I'd like to summarize those concerns that we have
21 submitted in writing.

22 I'd like to divide my comments into two

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 categories. The first relates to the procedural
2 approach that the JCCT Working Group should follow to
3 be consistent with the negotiators and the
4 congressional intent in examining China's NME status.

5 The second relates to some of the structural
6 characteristics of the PRC economy and that must be
7 taken into account when considering China's treatment
8 as either a nonmarket economy under our trade laws.

9 With respect to the procedural approach,
10 we are concerned the Department's notice makes no
11 mention of the intent of the terms of China's
12 accession to the WTO. The accession agreement should
13 be the starting point for considering any changes in
14 China's status. The draft protocol and the accession
15 of the PRC specifically places upon China the burden
16 to establish that they have met the criteria for a
17 change in treatment under U.S. law.

18 Unless and until China can demonstrate
19 that it has met this burden, the United States is
20 permitted to treat China as a nonmarket economy for
21 the first 15 years of China's membership in the WTO.

22 I am concerned that the process is being

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 used more as a negotiating purposes than as a standard
2 of performance that must be met by China. The
3 impression that I and others have is that the
4 Administration is saying that if China can meet a
5 defined and limited set of conditions, then market
6 economy status is justified. We disagree with that
7 approach.

8 Simply put, China is a pegged economic
9 system of interference at local, provincial and
10 central levels. Coupled with the lack of
11 transparency, make it difficult, if not impossible,
12 for U.S. companies to identify all the measures that
13 need to be address in order for China to gain market
14 economy status.

15 It was for this reason the negotiators
16 determined the necessity to put the burden of proof on
17 China. This process of predetermining what those
18 standards are run counter to the original intent of
19 the provision negotiated by China and the United
20 States. Asking U.S. companies to identify the
21 multiple layers of official and unofficial barriers to
22 efficient operation of the markets in China

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 essentially reverses the burden of proof.

2 It is important to recall that the 15-year
3 period in which China would be treated as a nonmarket
4 economy was identified as the reason why Congress
5 should vote to pass legislation implementing China's
6 WTO accession in the associated U.S.-China bilateral
7 agreement under U.S. law. And any determination by
8 the Department should be made in light of a
9 comprehensive examination of the PRC's economy and a
10 clear demonstration by China that it has met the
11 burden of proof of all statutory criteria pertaining
12 to its status. Failing to do so would risk
13 undermining the bargained breached in the United
14 States Congress.

15 With these specific conditions of China's
16 accession in mind, I would like to turn to the
17 relevant, structural characteristics of the Chinese
18 economy that should be considered by the Working
19 Group.

20 First, the Working Group should consider
21 China's restrictions on currency convertibility and
22 the undervaluation of their Renminbi. The Renminbi

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 unofficially pegged the U.S. dollar at a fixed
2 constant rate over the last decade is significantly
3 undervalued. Although estimates vary, economists
4 estimate that the Chinese currency is undervalued by
5 as much as 75 percent.

6 This undervaluation results in internal
7 and external distortions in the value of PRC goods and
8 services. The undervaluation represents a subsidy to
9 Chinese exporters and attacks on U.S. exporters, not
10 only for exports to China, but for exports to third
11 markets.

12 We recognize that the Department of the
13 Treasury is actively working with China to set the
14 conditions to eliminate the undervaluation. However,
15 we are concerned that even with the flow to their NMB,
16 the exchange rate will be sufficiently managed to deny
17 U.S. exporters access to China. In short, we believe
18 that even with a change in China's exchange rate
19 policy, the Department should weigh carefully whether
20 China has established a clean or a dirty float.

21 Second, the Working Group should consider
22 the PRC's restrictions on labor rights. Workers in

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 the PRC are not free to organize. They are punished
2 when they attempt to establish collective bargaining
3 rights or protest working conditions. Because of this
4 lack of labor freedom, Chinese manufacturers tend to
5 rely on greater labor input because they can obtain it
6 at artificially low, nonmarket prices.

7 Along with the nonmarket valuation of
8 other inputs, China's severe restrictions on labor
9 rights distorts the true economic cost of production.

10 We suggest the Department study carefully the Section
11 301 petition filed by the AFL-CIO regarding the
12 measures that must be addressed.

13 Third, China continues to pursue
14 discriminatory policies toward foreign investment that
15 prevent foreign companies from competing in certain
16 state-owned and dominated industries. The
17 International Monetary Fund reports that China imposes
18 restrictions, prohibitions and requirements for
19 government approval on nearly all transactions
20 involving capital and money market instruments,
21 derivatives, credit operations, real estate and direct
22 investment. There is an outright ban on foreign

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 investors from establishing wholly-owned subsidiaries
2 in some 10 percent of all industries. Moreover, since
3 early 2002, domestic Chinese enterprises have received
4 liberal import and export rights from the Ministry of
5 Foreign Trade in cooperation with the now new Ministry
6 of Commerce. However, those same rights have not been
7 granted to foreign investment enterprises.

8 Fourth, the Working Group should examine
9 the degree to which central, provincial and local
10 governments have maintained and/or expanded the powers
11 of influence of government-owned and government-
12 invested enterprises as instruments of economic
13 policy. The Minister in charge of the State Economic
14 and Trade Commission, Li Rongrong, stated in a recent
15 interview that state-owned enterprises are the
16 foundation of the socialist economic system. Mr. Li
17 pointed out that the continuous increase in the
18 overall strength and structural optimization of state-
19 owned enterprises has improved the quality of the
20 public economy in China considerably. He maintained
21 that the PRC is committed to using public ownership as
22 a means to promote economic and social development in

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 China.

2 The Heritage Foundation's 2004 Index of
3 Economic Freedom which rates China as mostly unfree,
4 suggests that China's new leadership seems inclined to
5 slow down or even halt massive economic reforms
6 undertaken previously. It appears that rather than
7 eagerly pursuing progressive market-oriented economic
8 policies, the PRC remains committed to fundamental
9 aspects of central planning.

10 Fifth, the PRC continues to intervene in
11 the market through resource allocation and price
12 mechanisms. The Chinese State Power Corporation, a
13 corporation, owns 46 percent of the country's
14 generation assets and 90 percent of the total
15 electricity supply assets. Although there have been
16 plans to reform the industry, these plans have yet to
17 come to fruition. A lack of energy, price competition
18 and the existence of state monopoly power attest to
19 the nonmarket status of any industry that relies on
20 energy for manufacturing. The Chinese government also
21 controls the basic commodities for energy production,
22 namely all hydro-electric power, oil reserves and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 natural gas reserves in China.

2 The government also intervenes in the
3 market by setting price controls on some retail
4 products. An example can be found in color
5 television, China's color television industry. Color
6 televisions have been subject to direct price control
7 measures instituted jointly by the State Planning
8 Committee and the Ministry of Information in 1999.
9 These measures establish a China-wide price floor and
10 introduced a periodic national reporting of average
11 production costs in order to normalize producers
12 pricing behavior. Such measures do not comport with
13 market principles.

14 Sixth, the Working Group should consider
15 that the Chinese government remains firmly in control
16 of the banking sector and direct lending to state-
17 favored projects, businesses and individuals. This
18 control is used to facilitate the de facto
19 subsidization of domestic manufacturing companies.

20 Finally, the Working Group should consider
21 a number of other factors that indicate that the PRC
22 economy cannot properly be characterized as market-

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 based, for example, foreign firms and investors cite
2 the implementation of laws among the most critical
3 operating challenges of doing business in China. The
4 Working Group should discuss the lack of transparency
5 and predictability in the Chinese legal system and the
6 lack of consistent enforcement of laws in the business
7 environment.

8 The Working Group should examine the
9 extent to which the Chinese government provides access
10 to state research and development programs, but denies
11 such access to foreign companies. The discussion
12 should inquire into the extent of ownership and
13 influence of the Chinese military and the Chinese
14 economy. And finally, the Working Group should
15 examine the role of the government-owned and
16 controlled media and the extent to which these
17 agencies engage in direct and indirect discrimination
18 against foreign firms.

19 This last point brings me full circle in
20 demonstrating the difficulty that U.S. firms and
21 industries have in identifying all of the measures
22 that are critical in determining China's status as a

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 nonmarket economy country. The overlapping
2 governmental and unofficial measures that impinge on
3 market performance are difficult to observe because
4 the most obvious measures obscure the underlying
5 barriers to market performance. For this reason, we
6 believe that the Department of Commerce should
7 establish an advisory body with which to consult
8 during the deliberations of the JCCT Working Group on
9 the issue of standards that China should meet in order
10 to gain market economy status, whether that status is
11 granted on a sectoral basis or on an economy-wide
12 basis.

13 I thank you for the opportunity to appear
14 before you and I welcome any questions that you might
15 have.

16 Skip?

17 MR. HARTQUIST: Do you want to question
18 Bob, or do you want me to go ahead with my testimony?

19 MR. JOCHUM: Why don't you go ahead, Skip?

20 MR. HARTQUIST: Okay, thank you, Mr.
21 Jochum. I have some copies of the testimony for your
22 convenience. Again, for the record, I am David A.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 Hartquist of the law firm of Collier Shannon Scott and
2 I am testifying this morning in my capacity as
3 Executive Director of the Committee to Support U.S.
4 Trade Laws, CSUSTL, or CSUSTL., which is an
5 organization of trade associations, companies, labor
6 unions in a very broad range of U.S. manufacturing,
7 agricultural and service industries and as the name
8 implies the Committee to Support U.S. Trade Laws is a
9 group that strongly supports U.S. trade laws dealing
10 with issues like anti-dumping, with countervailing
11 duties and other such trade practices.

12 I'd like to underscore just a couple of
13 points that Bob Cassidy raised and also to reiterate
14 his role in leading the U.S. negotiating team when
15 China was seeking to accede to the WTO. He knows
16 where all the bodies are buried and probably presents
17 excellent testimony in terms of his background and
18 knowledge of China and its trade practices.

19 The first comment I'd like to make
20 concerns a close relationship between the Chinese
21 government and its manufacturing sector. These close
22 relationships continue to exist and that is clear from

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 the following very simple linkages that we have
2 observed in many areas in the manufacturing sector,
3 including the Chinese relationship with its steel
4 industry.

5 China has a very simple, but elegant,
6 scheme to subsidize domestic industries. Essentially,
7 the government directs the government-owned banks to
8 provide financing to certain sectors of the economy.
9 The government-owned banks do so providing
10 preferential financing and in some cases from
11 international institutions like the World Bank or
12 foreign AID-type funds. Then the government tells the
13 government-owned banks, perhaps not to require
14 repayment of these loans. And that is one reason why
15 it's estimated that the Chinese banking system has
16 something like \$500 billion in bad loans outstanding.

17 Certainly, this is not a characteristic of a market
18 economy.

19 The Committee to Support U.S. Trade Laws
20 also wants to reiterate the concern raised by Mr.
21 Cassidy that the United States and other trading
22 partners follow the protocol established by the WTO

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 for any change in China's treatment as far as trade
2 remedy cases are concerned. It not only sets a
3 dangerous precedent, it would set a dangerous
4 precedent to ignore the clear letter of the
5 international agreements, but would undermine the
6 effectiveness of future negotiations with China or
7 other countries. China understands the obligations it
8 has agreed to undertake and we must enforce our rights
9 under the accession agreement.

10 And lastly, China has a long way to go
11 before qualifying as a market economy. Simply put,
12 China quite clearly does not meet the test for market
13 economy status. That said, if the Working Group is
14 seeking these comments for the purpose of beginning a
15 dialogue with the Chinese on key areas where change
16 must occur before it will be considered for a change
17 in status, that is well and good. Any goal beyond
18 that at this point, however, in our judgment, is
19 premature and contrary to the provisions of the
20 accession protocol.

21 Thank you for your time and Mr. Cassidy
22 and I would be happy to respond to any questions.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 MR. JOCHUM: Thank you, gentlemen. We
2 appreciate your contribution and Mr. Cassidy, I have
3 relied on you for many years on your knowledge of
4 China. I appreciate you coming today.

5 I did have a more broad question. The
6 fundamental issues that you cited in terms of currency
7 manipulation, but even central planning of the
8 economy, labor market, to what extent was this taken
9 into account in the accession discussions with the
10 Chinese, whether that was relevant at the time?
11 Obviously, these are significant issues that you've
12 raised and the WTO accession provided us some leverage
13 to address issues in the Chinese economy and their
14 policies and practices. Were these issues discussed
15 and to what extent? And were we able to make any
16 progress using that venue to sort of raise some of
17 these issue to the Chinese?

18 MR. CASSIDY: Well, Terry, quite frankly,
19 is probably even in a better position than I am since
20 Terry was one of the key members of that negotiating
21 team. At the time the objective was to -- is to reach
22 agreement on how we would be able to proceed once

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 China enters into the WTO in using our anti-dumping
2 laws and to a certain extent also our CBD laws,
3 although we don't apply them at the present time.
4 Those were envisioned in those negotiations.

5 And Li Rongrong asked many of the
6 questions of what would be the conditions that would
7 be met, but as far as negotiating those terms during
8 those negotiations, it just simply wasn't the
9 objective of those negotiations to try to address the
10 underlying causes of what constitute China's nonmarket
11 economy. It was really more to identify what the
12 range of measures that would be considered when and if
13 China applied for market economy status either on a
14 sectoral or industry-wide basis or as an economy-wide
15 basis.

16 MR. JOCHUM: And for both of you, Mr.
17 Harquist, you mentioned the high level of outstanding
18 loans which I think is troubling to all of us. Given
19 the state of the financial sector, do you have an
20 opinion on what the effect of the currency
21 reevaluation would be on that sector?

22 MR. HARTQUIST: Well, that's something

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 that both Bob and I have been worrying about for some
2 period of time. Recently, as you may know, we're
3 counsel to a group called the Fair Currency Alliance
4 which has been considering filing a Section 301
5 petition against the Chinese based upon the
6 manipulation of their currency.

7 The concern that we have is that the
8 Chinese currency puts U.S. manufacturing at a
9 substantial disadvantage, both in terms of the impact
10 on underpriced Chinese imports and essentially
11 overpriced American imports into China. Bob mentioned
12 the estimates of the range of undervaluation up to
13 about 75 percent. The peg that we put is we think
14 that the currency should be revaluated by about 40
15 percent upward.

16 Clearly though in our discussions,
17 particularly with the Treasury Department on this
18 issue, there is concern about the impact that a sudden
19 substantial revaluation might have on the Chinese
20 banking system and beyond that, the impact that the
21 growth in that China's economy has had in spurring
22 recovery in Asia and investment in China,

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 particularly. So the fear is that if there is a
2 sudden revaluation and it's too significant, that that
3 could throw the banking system into turmoil.

4 It's our understanding that in the last
5 year or so China put about \$170 billion of government
6 money into the government-owned banking system to prop
7 it up and prevent it from failing and I believe that's
8 a matter of public knowledge.

9 So that concern remains and our objective
10 is to convince China that they need to take steps with
11 a clear plan, carefully thought out, to revalue the
12 currency while not essentially torpedoing their
13 banking system. The U.S. Treasury Department has sent
14 a technical support team over to China to work with
15 them on these issues and to consider the full range of
16 these issues.

17 So it is a matter of concern, because I
18 think it's -- the state of China's economy is
19 important to the U.S. economy as well, with all of the
20 ties that we have. So the basic point I would make is
21 that these are matters which are under considerable
22 consideration by experts in this field and we support

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 the efforts to develop a conclusion that essentially
2 is not going to upset the apple cart, but preserve or
3 develop a competitive relationship with China which
4 makes a lot more sense than what we have today with
5 the undervalued currency.

6 Bob?

7 MR. CASSIDY: Let me just add another
8 aspect because we're talking about what would happen
9 if there were a revaluation to bring China's currency
10 more in line with economic fundamentals. But there's
11 also a flip side to that and I think we're seeing that
12 now, that in the absence of any adjustment in the
13 currency, what we're seeing is a lot of structural
14 changes that are taking place in the Chinese economy.

15 Foreign exchange reserves are over \$420 billion and
16 that's about a third of their GDP. The result of a
17 fixed exchange rate that's undervalued means that
18 China must convert that to Yuan and so it must print
19 Renminbi and so it's increasing the amount of
20 resources that are actually going into the banking
21 system. That banking system, in turn, does what
22 banking systems always do. They lend the money out

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 and they're lending it, in our view, continuing to
2 lend it out to inefficient and noncreditworthy
3 institutions.

4 And we believe and probably over time
5 we'll be able to demonstrate that the net result is an
6 increase in capacity far in excess of what the Chinese
7 economy needs or indeed what the global economy needs.

8 In textiles alone, for example, in the products that
9 are traded now outside of quota, we're seeing that the
10 price effect of Chinese products in the U.S. market
11 are 30 percent below world prices for that and that's
12 because of the increase in capacity that has been
13 generated in China in part because of the
14 undervaluation. So I think that there are -- there's
15 a flip side to that.

16 They need to do something and failure to
17 do something is going to have consequences as well, so
18 the consequence is either way.

19 MR. JOCHUM: Thanks, that was very
20 helpful. For the information of the panelists, we've
21 covered about three or four tabs now in your briefing
22 book, so I want to make sure everyone's caught up and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 maybe I should give Mr. Loevinger some equal time on
2 this currency question.

3 David, please.

4 MR. LOEVINGER: Thanks, Jim. First, I
5 just wanted to follow up with David's comment, very
6 quick comment on the banking sector. We, too, at
7 Treasury are quite concerned about the Chinese banking
8 sector and see as perhaps one of the biggest
9 weaknesses that they have in their economy. We have
10 seen time and time again throughout Asia, it happened
11 in Japan in the 1980s, in Thailand and elsewhere in
12 Southeast Asia in the mid-1990s, countries go through
13 credit booms that end in busts and so we are sending
14 experts from the Treasury Department to Beijing in
15 about two weeks to talk, in particular, about our
16 experience in the U.S. on how to deal with
17 nonperforming assets, nonperforming loans, how to get
18 them off banks' balance sheets and so we -- I just
19 wanted to reiterate that I think we share your concern
20 and we're doing as much as we can and also working
21 with the World Bank and International Monetary Fund in
22 helping to provide China the technical expertise that

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 it needs to start cleaning up its banking system.

2 I wanted to turn to a couple of questions
3 on the exchange rate that Bob raised in his testimony.

4 One issue that we're very interested in learning more
5 in regards to China's status as a nonmarket economy.
6 I've heard many people talk about limits on the
7 convertibility of currency and people have talked
8 about the exchange rate regime, but then there's also
9 the question of undervaluation and it's something that
10 both of you mentioned.

11 And what I've heard a range of speakers
12 say is one reason why it would be premature at this
13 time to give China market economy status is because of
14 the prevalence of price controls throughout the
15 economy. And what we have told the Chinese is that we
16 actually have no idea what the right exchange rate for
17 China is. What we do believe is that China, just like
18 other large economies, should let the market play a
19 much bigger role in determining what the exchange rate
20 is. And whatever the right exchange rate is for
21 China, one reason why they need to move to a more
22 flexible exchange rate regime is the right exchange

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 rate is going to change over time.

2 So I'd be very interested to hear from Bob
3 when he suggests that undervaluation should be a
4 factor in determining whether or not China is accorded
5 market economy status, whether he's suggesting that
6 the U.S. government should figure out what China's
7 exchange rate should be, and compare it to what it is
8 and then how it should take into account the dynamic
9 factors, that all these studies that try and estimate
10 the equilibrium exchange rate in China, they're all
11 based on a methodology that admits that equilibrium of
12 exchange rates change over time. And also, if we're
13 successful in getting China to move to a more flexible
14 regime, I mean you can look at the U.S. dollar, you
15 can look at the Japanese Yen. There's quite a bit of
16 movement from one year to the next. So that a
17 currency may or may not be over or undervalued in one
18 year, but that will change, if we're successful in
19 moving to a floating exchange rate.

20 So I guess it would be useful for me to
21 hear a bit more kind of the practical implications of,
22 Bob, how you would suggest we actually take this into

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 account in making any determination?

2 MR. CASSIDY: Well, I would share your
3 observation that it is a dynamic process of
4 determining whether an exchange rate, what the
5 exchange rate would be to reflect my economic
6 fundamentals and that exchange rate may change. In
7 fact, we see that frequently in exchange rate
8 fluctuations in market economy countries.

9 But that's not to -- I don't know as I
10 necessarily take the opposite point that simply
11 because we cannot predict it over any one defined set
12 of time, set time period, whether that means that we
13 should discount the whole thing. Fundamentally, there
14 are differences in estimates of undervaluation, but
15 you know, everybody agrees that it's undervalued. The
16 estimates range generally between 20 and up to 75
17 percent. That's a significant undervaluation.

18 I know that Treasury -- we have spoke to
19 Ambassador Spelts and he's working diligently along
20 with others at the Treasury Department to see how this
21 can -- structural changes in the capital -- in the
22 banking system can help facilitate a movement towards

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 a floating exchange rate.

2 Certainly that would help, but the most
3 immediate concern is that the undervaluation is
4 creating a competitive advantage and with such an
5 extreme undervaluation it's difficult to argue, at
6 least in my view, how you can say that prices are
7 determined in a market situation in China, at least as
8 far as foreign is concerned, foreign access is
9 concerned. So it does distort the market place of
10 setting prices in China. And I think that's the
11 variable that we're looking at here.

12 What is the ultimate exchange rate that
13 China will have? I don't know exactly what that will
14 be, but certainly are and may be true to about 40
15 percent in my view would be what that change would be.

16 And how you get there, that is probably the biggest
17 challenge, in my view, for the Treasury Department in
18 trying to determine how to work through that process.

19 Is it through an immediate revaluation of the
20 currency, but still fixed? Is it a combination of
21 going to a basket of currencies as the IMF has
22 recommended? Is it a quick movement to a float and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 there have been many who have criticized that as being
2 -- that might threaten capital outflows as opposed to
3 inflows.

4 All of these are imponderables that the
5 Treasury Department is wrestling with, I think. But
6 clearly, the undervaluation of the currency itself
7 makes it difficult to argue that China essentially is
8 a market economy country where such distortions take
9 place, 40 percent difference in what the exchange rate
10 should be.

11 We have done a comparison of China's trade
12 data and we have used a comparison of China's -- the
13 date that was reported by China and that is reported
14 by foreign countries, sort of the inverse
15 reconstructing the trade data. And we see enormous
16 differences in the data of about \$170 billion
17 difference. And you know, this just demonstrates once
18 again the imperfections in the marketplace that exist
19 and it's not just in the currency exchange, but it's
20 also in the transparency of the system, the data
21 that's being used.

22 So I would argue that indeed that an

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 exchange rate change is necessary and it's going to be
2 necessary as one of the conditions for China to gain
3 market economy status and I think Ambassador Zoellick
4 was when discussing whether the Administration will
5 accept an AFL-CIO petition or whether it would accept
6 a CA petition on exchange rates argue that this would
7 be a mechanism for addressing that issue.

8 MR. HARTQUIST: May I supplement Bob's
9 comments very briefly? First of all, the degree of
10 manipulation and control by the Chinese of its
11 currency, we think is simply unprecedented
12 historically. There's never been a regime that has
13 operated like this one. And I'll put it more simply
14 than Bob did. China is hiding the ball on their
15 numbers. They're publishing data which are simply
16 incorrect about its trade status and thus far they've
17 gotten the Treasury Department, we believe, and the
18 International Monetary Fund to buy their numbers, but
19 they say their global trade surplus is about \$45
20 billion a year. We just reverse engineered the
21 numbers and calculated the data based upon their top
22 43 trading partners representing 95 percent of their

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 trade and when you look at the data that all other
2 countries indicate they have with the Chinese, they
3 understate their global surplus by about 300 percent.
4 I mean it's huge.

5 And the other comment I would like to make
6 really is a practical comment and that is this is a
7 very urgent situation for American industry and labor.

8 What we're seeing and you've seen it in anti-dumping
9 cases that we have filed with the Commerce Department,
10 for example, on saccharine and the recently decided
11 color television case, is because of the competitive
12 advantage that the Chinese have with respect to their
13 currency, they're able to come in and simply devastate
14 U.S. markets in the very short term.

15 In my experience, normally what you see is
16 a period of years of undervalued imports, dumped or
17 subsidized imports coming in, two, three, four years
18 and the problem gets worse a little bit each year and
19 then a case is filed to deal with it. In this
20 situation, the Chinese can come in, in months, four
21 months, six months, well under a year and simply
22 devastate an entire industry. And this is an issue

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 that is simply crying out for resolution and I don't
2 think it would be responsible for the U.S. government
3 to provide market economy status to the Chinese for
4 many reasons, but most of all, because of the
5 manipulation of their currency and the degree of
6 artificial advantage that's provided to their
7 producers.

8 MR. LOEVINGER: Jim, if it's okay if I
9 could follow up. Just on this one issue, it's very
10 important for us to understand some of the practical
11 implications of your suggestions and first I'd say on
12 data. I mean we'd be the first ones to agree that we
13 take all Chinese data with a grain of salt and know
14 that they have a lot of work to do to improve their
15 statistical system.

16 But let's say that we are successful in
17 getting China to do what we've been pushing them to do
18 for over a year now which is move to a more flexible
19 exchange rate regime, reduce some of the restrictions
20 on currency convertibility, particularly in the
21 capital account. Let's say we succeed. Are you then
22 suggesting that an additional step we would need to

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 take is to say the U.S. government thinks China's
2 exchange rate should be at this level? China's
3 exchange rate is not at that level and therefore on
4 that basis you're not a market economy?

5 MR. HARTQUIST: My short answer would be
6 that that is one of many factors for the U.S.
7 government to consider. If they make progress in this
8 respect, it would be an important step forward, but
9 it's certainly not the final answer. It's one of many
10 factors that must be considered.

11 MR. CASSIDY: And I would also point out
12 that even if they go to a float, then a question
13 arises as to what extent is it managed and that's
14 something that I would hope that the Treasury
15 Department would continue to monitor that to ensure
16 that at least in the process if there's some
17 variability in the exchange rate and it does reflect
18 the underlying economic fundamentals.

19 MR. JOCHUM: I would just note on the
20 issue of statistics of the JCCT, one of the outcomes
21 we achieved last month was actually a bilateral
22 dialogue on this exact issue at the initiative of

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 Secretary Evans who believes that we have some
2 fundamental problems with the data that we're seeing,
3 so we've agreed to send experts over and have a
4 discussion on how they gather statistics and how they
5 release those to try to upgrade our mutual
6 understanding of how that occurs.

7 David, one more?

8 MR. LOEVINGER: Thanks, Jim. I would just
9 like to follow up with a different set of questions on
10 an issue Bob raised about currency convertibility
11 because as you're well aware that is clearly specified
12 in the statute as being an important factor in
13 determining whether an economy should be accorded
14 market status and I think Bob, as you noted, China
15 still has a range of controls in converting its
16 currency for foreign exchange for investment purposes.

17 China, on the other hand, has met its obligations as
18 an IMF member to allow complete convertibility for
19 trade transactions or what's called current account
20 transactions. And a question we have is and I think a
21 number of speakers and panelists have mentioned is the
22 real practical issue is the question of degree. How

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 far do we want them to go? The currency is
2 convertible for current transactions. It's
3 convertible for some capital account transactions, but
4 there are restrictions for other capital account
5 transactions. There's probably not a country in the
6 world that has complete convertibility on capital
7 account. Most -- almost all countries have some
8 capital account restrictions. We, the U.S., have some
9 restrictions on foreign direct investment. And I
10 think also Secretary Snow has highlighted as have a
11 number of experts that given the weakness in the
12 banking sector that you mentioned and other speakers
13 mentioned that complete removal of all controls on
14 capital outflows could be quite destabilizing to the
15 banking sector in the near term.

16 So the question is what exactly should we
17 be pushing for? Because we are pushing quite hard for
18 them to remove restrictions on capital account, but
19 what do you think are the most important things that
20 we should be pushing for?

21 The other thing we're quite aware of is
22 that China's capital controls are asymmetric. There's

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 many more controls on capital outflows than on capital
2 inflows, so that to the extent we're pushing broadly
3 for the removal of capital account restrictions that
4 will lead over time to greater downward pressure on
5 the currency and balance of payments.

6 MR. CASSIDY: You know, this is one of the
7 issues that we wrestled with in our discussions within
8 the Fair Currency Alliance as to what extent were we,
9 was the obligation on us to try to provide the whole
10 range of what the final solution would be.

11 You're quite right that each country has
12 specific regulations that evolve over time and some
13 are more open than others. It seems to me that the
14 measure should be is what is the impact, not whether
15 you go through a checklist that each one of the 25
16 items need to be addressed, but more importantly what
17 is going to be the ultimate effect or are there
18 results that we can see demonstrated?

19 First of all, the undervaluation of the
20 currency is so huge that it's difficult to be able to
21 pass through what the other ones are to find out where
22 is equilibrium in all the other measures. When you

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 have such a distortion and this is the -- one of the
2 fundamental arguments we have is that it's difficult
3 for those of us in the private sector and I would say
4 it's also difficult for government people as well as
5 to be able to pass through what all those measures are
6 and what their individual impact will be on setting
7 prices within the economy.

8 And when there is such a distortion in the
9 exchange rate itself, it sort of masks what is the
10 impact of the -- the marginal impact of each one of
11 the different restrictions would have. And so for
12 this reason this is why we suggest that the setting up
13 an advisory group with private sector so that as these
14 measures are dealt with, when Treasury is successful,
15 and I believe Treasury will be successful in that and
16 when other measures are adopted, then we can see to
17 what extent these other measures do have a significant
18 impact or are they just purely marginal and will not
19 impact it.

20 But it's very difficult for those of us in
21 the private sector to be able to assess it and had
22 felt that we need to put our trust in Treasury in

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 being able to discern which ones are the most
2 significant in setting up an exchange rate that is
3 market determined and what those capital controls
4 would be that would achieve that end or substantially
5 achieve that end.

6 MR. JOCHUM: Any further questions from
7 the panel?

8 Shaun?

9 MR. DONNELLY: Bob, could I just ask
10 drawing on your experience with China over the years,
11 what you see regarding state-owned enterprises, are
12 they -- is the extent of government influence
13 increasing, decreasing? Are they being run with more
14 or less attention to commercial factors? Is there a
15 difference between large and small state-owned
16 enterprises or something? I just wonder if I could
17 get your assessment of any trends or particular
18 problems you discern in that area?

19 MR. CASSIDY: You know, I remember that
20 when we were doing negotiations, Zhu Rong Ji himself
21 used to comment on this frustrations on dealing with
22 the state-owned enterprises and I think his objective

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 was to make them more responsive to market conditions,
2 etcetera. I think he felt incredibly frustrated at
3 the inability to achieve that end. There are other
4 state-owned enterprises at the state level and there
5 are those at the provincial and local governments and
6 I think the desire of the government is that not be so
7 much -- they don't control every aspect of it, but so
8 much is done through the credit system, through the
9 banking system in providing the resources for these
10 state-owned enterprises and there's so many problems
11 in the accounting system of each one of these state-
12 owned enterprises. The ranges of books they have for
13 different purposes is really outstanding. They have a
14 set of books for each separate purpose and the
15 anecdotal evidence that we've heard on how they're
16 able to avoid specific measures or specific taxes,
17 etcetera are enormous. I think the desire was on the
18 part was to grow the private sector and hopefully that
19 the state-owned sector could atrophy. There is an
20 attempt and has been an attempt to privatize it.

21 But it's not just the extent of the
22 government control sort of at the board level or

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 dictating what the policies will be, but it's also the
2 allocation of credit, loans you have to look at and
3 then is the whole range of provincial and local
4 control as well because so much of that is done on a
5 provincial and local level.

6 I think that, because of the complexity of
7 it, and the involvement at all levels of government
8 and state-owned enterprises, and provincial and local
9 enterprises, I think that was partly the reason why it
10 was so difficult for the Chinese government to at
11 least during Zhu Rong Ji's period on trying -- being
12 able to address it. I'm not so sure how easy it's
13 going to be.

14 That's why I think, as I remember it,
15 Terry, and you can correct me if I'm wrong, that's why
16 we -- our emphasis was when we talked to the Chinese
17 on when nonmarket economy might satisfactorily be
18 granted that our internal thinking was it was probably
19 more likely on an industry-sector basis rather than an
20 economy-wide basis because there may be pockets of
21 competition that exists in China far earlier than it
22 will exist for the whole economy.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 MR. HARTQUIST: You, they turn on and off
2 the spigot and a couple of weeks ago there were press
3 reports that there was a concern in the steel
4 industry, it was overheating and is overheating.
5 They've over built. A couple of years ago all of the
6 information that came out was we're building for our
7 domestic economy, we need steel in the Chinese
8 economy. A couple of weeks ago, the government said
9 looks like there's going to be too much. No more
10 money for the steel industry. Okay, last week, you
11 could get the loan, tomorrow, you can't. Or they
12 simply shut down the whole banking system. About a
13 month ago they just said this week, we're not going to
14 make any more loans. I mean can you imagine walking
15 into Bank of America and they say you can't have a car
16 loan this week?

17 So when you ask a question like that, do
18 you mean March of this year or November of last year?
19 It's a world that changes very quickly.

20 MR. McCARTIN: I just want to quickly
21 follow up on that. One of your submissions you
22 mentioned that the government's influence over state-

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 owned enterprise is increasing. I just wonder if you
2 could elaborate on that further -- is there particular
3 sectors where it's increasing?

4 And what do you see as future trade
5 implications of this trend?

6 MR. CASSIDY: This seems to be, what we
7 have observed is more anecdotal and I mean it's done
8 based on some other research that has been done, but I
9 think most of that research has been more anecdotal,
10 that the trend in trying to reduce government
11 ownership is sort of at least stopped or perhaps even
12 reversed.

13 And in part, that may be because of the employment
14 pact. The states, the state-owned sector, they still
15 employ a huge population in China and it's just very
16 sensitive.

17 So we've just seen it's been more of a
18 slow down or an increase in that role, but in part,
19 that may also be generated by the banking sector as
20 well because of the printing of money, the banking
21 system having more money, in part because of the
22 undervaluation of the Renminbi. They have to then

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 finance more of this and so they're sending, putting
2 more money out into the state-owned enterprises and so
3 that's buttressing up the state-owned enterprises as
4 well.

5 I think the money is getting to the
6 private sector. I think it's getting more to the
7 state-owned sector and that's where the undervaluation
8 of the Yuan is having its impact throughout the
9 economy. That's why we say on that issue alone, there
10 will be problems with fixing it and there are going to
11 be problems with not fixing it.

12 And so the question is how do we manage a
13 soft landing so that it's -- so we can then discover
14 what are the other barriers that we have to deal with
15 in our market economy status.

16 MR. McCARTIN: Just one other question.
17 In your submission on behalf of the specialty steel
18 industry, you discuss China's weak rule of law and how
19 that impedes China's progress toward a market economy.

20 I just want to focus on one particular area and
21 that's real property rights, land ownership.

22 How does the weak rule of law in China

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 affect the granting and allocating of land use rights?

2 MR. CASSIDY: You know, could we provide
3 that an answer to that question in a subsequent
4 submission and let us do a little bit more research on
5 that?

6 MR. McCARTIN: Thank you.

7 MR. McINERY: Bob, while you're at it, a
8 number of us were intrigued by this rule of law
9 submission and it struck us that with the variety,
10 great variety of legal systems around the world, it's
11 really hard to a benchmark against which to measure
12 whether the rule of law has, in fact, become
13 established or the extent to which it's become
14 established. So if you have any thoughts on that
15 score, we all find the whole subject very, very
16 interesting and would be happy to consider any
17 additional suggestions you could make.

18 MR. CASSIDY: Thank you, John, that's a
19 worthwhile endeavor on how do you measure that. In
20 the area of intellectual property rights, some of our
21 clients working with them on this, how do you pursue
22 your intellectual property rights, not to mention real

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 property rights in a Chinese court which tends to
2 favor Chinese rights as opposed to foreign. And
3 that's something that -- how do you measure that?

4 Once again, I think that's where an
5 advisory group, an on-going advisory group that can
6 perhaps assist in that process of being able to try to
7 measure these in some fashion, it's difficult.

8 But once again, it's the constant series
9 of layers of measures that it's so difficult to
10 penetrate how to measure, how to identify the
11 significance of those internal barriers that are
12 overlaid with other more transparent and recognizable
13 measures. And I think as those other measures come
14 down, currency being one, the banking system being
15 another, we're going to be able to see to what extent
16 these other barriers are significant and which ones
17 are the most significant in that range.

18 MR. LEONARD: In the issues of layers and
19 intellectual property, we've had a number of I'll say
20 highly successful U.S. textile companies who are in
21 the home furnishings are, carpets, upholstery,
22 draperies, that sort of thing. These folks are

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 globally competitive. There's virtually no labor
2 content and yet, particularly in the carpet area with
3 the construction going on in China, there has been
4 massive IPR fraud. I mean Chinese carpet companies,
5 you open their catalogue and they have, it's a U.S.
6 company catalogue for all intents and purposes and
7 some of these companies have been very aggressive.
8 They've hired lawyers in China. They've won a number
9 of cases against their copyright and nothing ever
10 happens because in Beijing, you win, but the problem,
11 as you said, is at the province level or at the local
12 level and it's an issue of the Chinese having laws on
13 the books, but not being enforced. And so I think
14 these are areas that we all need to try to do some
15 work in and work with the Chinese and try to get them
16 to do a better job of enforcing it, not only at the
17 state level, but at the local level. We're working
18 very closely in the carpet area, for example, in
19 trying to develop a mechanism in China for
20 registration of patterns and try to give the Chinese a
21 little more input as to try to do something about
22 these. So any thoughts that you folks have in that

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 area, will be helpful.

2 MR. CASSIDY: Thank you. We'd be happy to
3 contribute to that process.

4 MR. HARTQUIST: I have a very brief, but
5 amusing anecdote along those lines. We put on a
6 seminar recently about IPR rights in China that was
7 extremely interesting and one of the folks who was
8 involved in the seminar talked about his relationship
9 with the Chinese and the agreement that he signed to
10 license his intellectual property in China and
11 essentially what he did was he said look, I know
12 you're going to violate this license. You're going to
13 knock off my product and steal my intellectual
14 property, so I want to have a second agreement with
15 you and that second agreement will be that I will have
16 the exclusive distribution rights of the knock off
17 product that's sold in the Chinese market.

18 (Laughter.)

19 MR. JOCHUM: He must have had a good
20 lawyer, Skip.

21 I would note that we have a separate
22 Working Group on intellectual property rights under

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 the JCCT, not that these issues aren't interesting to
2 us. In fact, obviously the foundation of trade is
3 your ability to protect your creative process.

4 I think Mr. Lorentzen is going to end up
5 this panel with a couple of questions.

6 MR. LORENTZEN: Thank you and I apologize
7 for holding you further, but I want to take advantage
8 of your being here to ask a couple of questions. One
9 is sort of a general over arching question which goes
10 to the issue that I'm most concerned about which is
11 how best to prepare for the work of the Structural
12 Working Group. And I asked the previous witness about
13 orders of priority in terms of taking up issues, but
14 I'd like to sort of alter the question a little bit
15 for you because it goes to the -- I think the first
16 issue is one of transparency and I think one of our
17 goals is to develop a complete base of information in
18 order to begin the next step which is to understand
19 the issues as clearly as we possibly can.

20 But beyond transparency is the issue of
21 understanding interaction of policies or practices
22 when you look at things such as state-owned

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 enterprises and property rights and the banking
2 sector.

3 So what I would be interested in is sort
4 of keeping those two goals in mind. Are there
5 particular recommendations that you would have for us
6 about how to frame and probe the issues as we go
7 through the examination of China's economy in the
8 context of the Working Group discussions and then if I
9 could come back with a more specific question after
10 that. Thank you.

11 (Pause.)

12 MR. CASSIDY: What is the right way? I
13 can't begin to tell you how many times I asked that
14 question, what is the best way or the right way to do
15 something in any negotiations and you know, it's -- as
16 long as you have the goal in mind, probably any way,
17 is going to be good.

18 Certainly, the statutory criteria provides
19 some guidance on what needs to be done in order to
20 meet that condition. But the first one I think is
21 currency convertibility. It doesn't really deal with
22 the undervalued Yuan and that, in my view, distorts

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 the marketplace so much that it's difficult then to be
2 able to arrive at enough transparency to be able to
3 determine what the other measures are.

4 When you have such a distortion in the
5 marketplace, it's difficult to look at the banking
6 sector in its role, the role of state-owned
7 enterprises, real property, intellectual property,
8 because that factor is distorting trade and markets so
9 much its distorting credit allocation. It's
10 distorting so much. So sometimes you just have to
11 deal with the big issue first in order to be able to
12 develop enough transparency to see among the capital
13 issues, capital control issues which ones are the most
14 difficult. Or in the area of real property, how do we
15 tackle that approach?

16 Once again, that's why I thought that an
17 advisory group that could help in this process would
18 be a good way of proceeding. Certainly there are key
19 things that I've heard mention, the currency issue,
20 the capital markets issues. Those were all relevant,
21 but they're not in the statutory provisions or are all
22 relevant.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 My concern is that the lack of
2 transparency in the Chinese system, it's opaqueness at
3 both the central, the provincial and local level,
4 makes it difficult to prioritize for you. And so I
5 don't envy you that task. And fortunately, you have
6 15 years.

7 (Laughter.)

8 MR. HARTQUIST: You know, I thought, Mr.
9 Lorentzen, that the statement that the Secretary put,
10 Secretary Evans put out, about three weeks ago or a
11 month ago, was very simple and very straight forward,
12 saying these are the things you must do, China, in
13 order to achieve market economy status. Certainly,
14 there's a lot of precedent in other cases where
15 countries have achieved market economy status and the
16 burden is on them to do it. But here, the kind of
17 question you ask is so immense. In our judgment,
18 China is not even in the ballpark, not even in the
19 parking lot to achieve market economy status yet. And
20 I think they have an obligation to come forth and say
21 here are the reasons why we think we should be given
22 market economy status and they haven't done that.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 MR. LORENTZEN: Thank you. My second
2 question is much more specific. It has to do with the
3 issue that you, Bob, mentioned in your oral remarks
4 and then I think it was covered in the submission on
5 behalf of Seimann Paper which has to do with power
6 generation and provision.

7 This is a sector that in market economies,
8 it's not uncommon for the government to have a role in
9 terms of more than the normal amount of regulation or
10 the so-called natural monopoly type situation, but
11 what sort of differences do you think distinguish the
12 situation in China from what we might call the
13 conventional market economy context in terms of power
14 generation and provision?

15 (Pause.)

16 MR. HARTQUIST: We are just conferring as
17 to how much we actually know about the Chinese
18 practices in this regard. I think our main concern is
19 that the cost of power bear a relationship to the
20 market and based upon the research that we have done
21 in various different contexts, we don't see that as
22 occurring. You know, it kind of reminds me of a visit

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 a manufacturer made to Russia a few years ago when he
2 asked about natural gas. Where do you get your
3 natural gas and what do you pay for it? And the
4 Russian producer said pay for it? It comes out of a
5 hose in the wall there. That's it. And so that is
6 our concern, that there be some market relationship
7 and frankly, we just don't see it in the research that
8 we've done thus far.

9 MR. CASSIDY: Can I just say part of the
10 problem that we have is that, of course, because of
11 the opaqueness of the Chinese economy it's difficult
12 to know exactly what's being done. If this were the
13 U.S. economy, someone doing a case against the United
14 States or Europe, all that -- everything is public, is
15 in public view and you can perhaps get everything you
16 need.

17 That information is just not available in
18 the Chinese system. It's sort of like some of the
19 negotiations where we can only say to them we know
20 something is wrong because it's not working like a
21 market would work, but we can't pinpoint what the
22 exact set of problems are.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 So to a certain extent I wonder if we
2 don't need a sort of a means test is that we'll know
3 it when we see it and that's -- it's not helpful as
4 far as having a list of things that you want to
5 accomplish and I've got five of the eight things that
6 I need to accomplish, but to a certain extent if you
7 can see to what extent prices do reflect the cost of
8 production. For example, what is the price of energy
9 going to be as a result of the increases in oil prices
10 and you'll be able to see something like this and so
11 to see to what extent those are able to be passed on.

12 These are the questions that I think that
13 we need to do is to look and see is price affected by
14 markets and by international markets since there's a
15 correlation between price movements and international
16 markets and in China and there are certain things
17 where you can see there that that might be a way of
18 providing some guidance as to whether it exists.

19 MR. JOCHUM: Gentleman, you can tell by
20 the number of questions your participation is
21 extremely helpful to us today. We really appreciate
22 it and I guess you've made a commitment to follow up,

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 so we will keep the record open, if you will, to
2 receive anything you have to add to that rule of law
3 question. Thanks very much for joining us.

4 MR. CASSIDY: Thank you very much.

5 MR. JOCHUM: At this time, I believe we're
6 about one hour ahead of schedule, so I thought we
7 would take a short break, 15 minutes and return
8 shortly after 12. We have four remaining witnesses
9 and my intent would be to close the proceed at about 1
10 o'clock, so hopefully, all of you can come back after
11 the break and we'll see you in 15 minutes. Thanks.

12 (Off the record.)

13 MR. JOCHUM: Okay, thanks for those of you
14 who made it back after a break. We are on the home
15 stretch. I believe we have four more scheduled
16 witnesses and hopefully even though we are about a
17 half an hour ahead of schedule, that they will join us
18 and we first will hear this afternoon from the law
19 firm of Skadden Arps and thank you for joining us.

20 MR. GERRISH: Thank you, Mr. Chairman. My
21 name is Jeffrey Gerrish. I'm with the law firm of
22 Skadden, Arps, Slate, Meaghan & Flom and I'm appearing

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 today on behalf of the United States Steel
2 Corporation.

3 We'd like to thank the Department for the
4 opportunity to testify here today on an issue of
5 critical importance to U.S. Steel and indeed to the
6 country as a whole. At the outset, I welcome the
7 assurances given by Chairman Jochum today that this
8 process does not represent and will not result in any
9 reconsideration of China's NME status. As part of its
10 accession to the WTO less than three years ago, China
11 agreed that the United States and other WTO members
12 could treat China as an NME for the first 15 years of
13 the country's WTO membership. This was an essential
14 part of the bargain struck by the United States and
15 was relied upon by Congress in approving the deal.

16 For its NME status to be reconsidered
17 before the end of this 15-year period, China must bear
18 the burden to demonstrate that it has satisfied each
19 and every one of the requirements of U.S. law for such
20 a change. Yet, the evidence conclusively and
21 unequivocally establishes that China cannot meet this
22 burden. In fact, the overwhelming weight of the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 evidence shows that China must undergo radical reform
2 before it is able to satisfy any of the six statutory
3 factors for graduating to market economy status under
4 U.S. law.

5 The first statutory factor to be
6 considered is the extent to which the Chinese
7 currency, the Renminbi or Yuan is convertible into the
8 currency of other countries. As the Department has
9 recognized, the greater extent of currency
10 convertibility for both trade and investment purposes,
11 the more market based the country's domestic prices
12 tend to be.

13 However, as the Department has heard from
14 witness after witness after witness today, the Yuan is
15 nonconvertible on a capital account basis. This means
16 that export earnings and foreign exchange, plus
17 foreign direct investment not utilized for purchases
18 on current account have to be sold to the Chinese
19 Central Bank for Yuan at a fixed exchange rate. This
20 has resulted in massive foreign exchange sales to the
21 Chinese Central Bank. In fact, the Chinese Central
22 Bank is purchasing U.S. dollars at a clip of roughly

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 \$120 billion per year. There is one and only one
2 purpose for these massive purchases of foreign
3 exchange, to manipulate the value of the Yuan. This
4 manipulation has caused China's currency to be
5 undervalued by 40 percent or more.

6 Clearly, therefore, the value of China's
7 currency is not set by the free flow of currency and
8 goods. To the contrary, China's currency is not at
9 all reflective of market forces and is not
10 convertible.

11 To move to market economy status, China
12 must also show that wage rates in the country are
13 determined by free bargaining between labor and
14 management. This it simply cannot do. Labor
15 conditions in China are abysmal and reflect the
16 complete absence of anything approaching free
17 bargaining between labor and management. In fact,
18 Chinese workers have virtually no freedom of
19 association or rights of collective bargaining. The
20 old China Federal of Trade Unions, which is controlled
21 by the communist party, is the sole legal workers
22 organization in China. Independent unions are

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 illegal.

2 Workers in China also have no right to
3 strike under Chinese law. Any form of worker protest
4 is met by government harassment, arrest, detainment
5 without trial and ultimately imprisonment. Given this
6 lack of rights and representation, it is not
7 surprising that Chinese workers are forced to endure
8 atrocious working conditions. Workers continue to
9 work incredibly long hours for extremely low wages.
10 Compulsory overtime is common, often without overtime
11 pay. The health and safety conditions in Chinese
12 factories also reflect the total lack of free
13 bargaining between labor and management.

14 The ILO has recognized China as the world
15 leader in industrial accidents with hundreds of
16 thousands of Chinese workers dying in such accidents
17 every year. In addition, workers living in factory
18 dormitories are forced to live under inhuman
19 conditions. They're often treated under conditions
20 that just are completely inhuman. Forced labor is
21 common in several different forms in China. It is an
22 integral part of China's prison system for both

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 individuals detained for re-education through labor
2 and prisoners serving formal criminal sentences.
3 Forced labor also occurs through the household
4 registration system in China. Labor conditions in
5 China clearly are not the product of free bargaining
6 between labor and management. In fact, just the
7 opposite is true.

8 Although there has been substantial
9 investment in China recently, the facts show that
10 significant barriers to investment continue to exist
11 in China and that the country remains far from
12 satisfying this problem of the NME test as well.
13 There are enormous obstacles to entering the Chinese
14 market. All foreign entities seeking to invest in
15 China must get advanced approval from the government.

16 Proposed projects are divided into four categories:
17 encouraged, restricted, permitted and prohibited.

18 The Chinese government clearly and concertedly seeks
19 to move investments toward encouraged industries in
20 regions. For restricted industries, the government
21 requires a Chinese controlling or majority ownership
22 interest and for prohibited industries, foreign direct

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 investment is prohibited all together.

2 Additionally, China's legal and regulatory
3 system suffers from a complete lack of transparency as
4 well as inconsistent and arbitrary enforcement of
5 regulations. Moreover, China still does not have an
6 impartial and effective court system. And foreign
7 investors face enormous difficulties in simply trying
8 to enforce a contract.

9 Therefore, it is no surprise that China
10 receives far less foreign direct investment per capita
11 than many other developing, as well as developed,
12 countries. Clearly significant barriers to foreign
13 direct investment continue to exist in China.

14 Another critical factor in the
15 Department's NME analysis is the extent of government
16 ownership or control of the means of production.
17 Here, the situation is clear. The government
18 continues to own or control much of the means of
19 production in China and its role is actually growing.

20 As the State Department has recognized, state-owned
21 or state-controlled entities continue to play the
22 leading role in the Chinese economy. In fact, a

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 substantial number of key sectors, such as automobile
2 and steel production are wholly or mainly reserved to
3 state-owned enterprises in China. The role of the
4 government in Chinese industrial production has
5 actually increased in recent years. In fact, the
6 average asset size of state-owned enterprises has more
7 than doubled since 1997, due to massive subsidies from
8 the Chinese government.

9 In particular, state-owned steel producers
10 in China have benefitted from huge state subsidies.
11 The steel industry has been one of the major
12 recipients of low interest loans from state-owned
13 banks. In addition, the Chinese government provided a
14 staggering \$10.8 billion in debt to equity swaps to
15 state-owned steel producers in 1999 and 2000 alone.

16 As a result of these massive subsidies,
17 the 65 state-owned steel companies in China were able
18 to make \$6 billion in capital expansion expenditures
19 in 2002. Clearly, the government's control of the
20 steel industry and of industrial production, in
21 general, remains substantial and is growing.

22 The evidence also clearly shows that the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 Chinese government maintains significant control over
2 the allocation of resources and the price and output
3 decisions of companies. The Chinese government
4 continues to impose price controls on 13 broad
5 categories of items, ranging from electric power to
6 transportation to telecommunications. The temporary
7 price floors imposed by the government in industries
8 with excess capacity also act as price controls. In
9 addition, there is strong evidence to indicate that
10 the Chinese government is currently engaging in
11 significant efforts to control pricing in the steel
12 market in China.

13 The government also actively intervenes in
14 companies' output decisions. For example, China's
15 State Economic and Trade Commission continues to
16 manage domestic steel production and export by setting
17 targets for production and export and by imposing
18 operational guidelines for China's steel industry each
19 year.

20 The Chinese government also exercise
21 enormous control over the allocation of resources and
22 investment decisions through a number of different

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 means. Perhaps most important is the government's
2 complete domination over the banking sector in China.

3 Virtually all domestic financial institutions in
4 China are state owned. This complete control over the
5 banking sector provides the Chinese government with
6 unlimited means to control lending and investment
7 decisions in China and therefore to control the
8 direction of the economy.

9 The government has used this control over
10 the banking sector to funnel huge sums of money to
11 loss-making, state-owned companies in order to keep
12 them afloat. In other words, the government used its
13 control over the banking sector to allocate
14 substantial resources to state-owned enterprises for
15 purely noncommercial reasons. This vividly
16 demonstrates not only the extent of the Chinese
17 government's control over the allocation of resources,
18 but also the fact that China clearly is not operating
19 as a market economy.

20 Finally, the Department may also consider
21 other appropriate factors in its NME analysis. The
22 Chinese government employs numerous incentive programs

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 that are designed solely to favor domestic producers
2 to restrict the sale of imported goods and to increase
3 exports to the United States and other countries. IN
4 particular, China manipulates it's value added tax so
5 as to serve all three of these purposes. By using the
6 value added tax and other incentive programs in this
7 manner, the Chinese government controls the market in
8 a way that is not reflective of a market economy.

9 The evidence here could not be any more
10 conclusive in showing that China exhibits none of the
11 characteristics of a market economy. In its
12 discussions with the Chinese government, the
13 Department should make clear that China must make
14 fundamental changes and developments with respect to
15 each and every one of the six statutory factors under
16 U.S. law before it even may be considered for
17 graduation to market economy status.

18 Thank you.

19 MR. JOCHUM: Thank you, Mr. Gerrish.
20 Questions from the panel?

21 MS. WHITE: Thank you very much. You did
22 talk about the lack of free collective bargaining and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 free labor and its effect, it wasn't market based. Do
2 you have any idea of the extent to which it makes a
3 difference in the steel industry versus maybe other
4 industries? Does it affect differently state-owned
5 enterprises versus the private sector? Do you have
6 any sort of feeling about the quantifiable or relative
7 differences that might make, and if things were not
8 that way, what the prices, what the effect would be?

9 MR. GERRISH: I'm not aware of any
10 distinction among different industries or whether
11 they're state-owned or privately owned in China. I
12 think everyone who has studied the problem has
13 indicated that it is a pervasive problem. It doesn't
14 seem to be limited to particular industries. I think
15 it affects the steel industry as much as any other
16 industry.

17 And in terms of how it affects -- how
18 prices are set and how, what costs companies incur,
19 it's not clear exactly how it affects those items, but
20 it clearly, clearly it's part of the price setting
21 mechanism and clearly is a huge part of what costs
22 they incur in producing their products. And clearly,

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 the lack of worker rights in China has contributed to
2 their ability to underprice their products in both, in
3 the home market and abroad and in their sales in
4 exporting to the United States and other countries.

5 MR. JOCHUM: Any further questions? Okay,
6 Mr. Gerrish, thank you very much for your
7 participation today.

8 MR. GERRISH: Thank you.

9 MR. JOCHUM: Next on the list is the
10 Cookware Manufacturers Association.

11 MR. RUSHING: Thank you, Mr. Chairman. My
12 name is Hugh Rushing. I'm the Executive Vice
13 President of the Cookware Manufacturers Association.
14 We represent the interest of 18 United States
15 manufacturing members, nearly all of whom have been
16 impacted to a great degree by the trading commodity
17 such as cookware and bakeware of Chinese firms.

18 Just to put this in perspective, China's
19 imports into the United States for calendar year 2003
20 amounted to \$640 million which was an increase of 31
21 percent over 2002. Those imports account for fully 53
22 percent of all cookware and bakeware that's imported

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 into the United States.

2 Conversely, U.S.-produced cookware and
3 bakeware exported to China in 2003 amounted to a mere
4 \$3.4 million. The reasons for this great imbalance of
5 trade are many. That China is not a market economy
6 contributes in a myriad of ways.

7 A majority of our members of the
8 association are now sourcing product in China in
9 response to the deflationary impacts of China's
10 dominance of the industry. Direct hourly employment
11 in the cookware and bakeware industry last year fell
12 by nearly 30 percent in the U.S.

13 First, a major reason that China is not a
14 market economy in our view is the continuing
15 transition of previously state-owned industries to
16 private enterprise with incentives and subsidies that
17 are granted to its new owners. We know of cases where
18 free equipment, forgiveness of rent, free raw
19 materials, subsidized fuel, cancellation of payroll
20 taxes, nonenforcement of minimum wage and work
21 standard laws have accompanied such transfers. Absent
22 the payment of true market prices for inputs, these

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 factories can compete in the marketplace with
2 artificially low prices in predatory ways. Even
3 plants built with foreign investment within China
4 cannot compete under these conditions.

5 Second, China's failed permitting process
6 makes it a nonmarket economy, we believe. Factories
7 are not allowed to sell other than to the customers.
8 They have permits to sell to. Some factories can only
9 export products, others strictly serve the domestic
10 market. Such strictures on sales distort the
11 distribution channels and vastly reduce competition.
12 Our members' experiences are that there are no
13 transparent ways in which such permitting or licensing
14 is accomplished. It's a bewildering difference from
15 location to location, from city to city, from province
16 to province.

17 Thirdly, a distorted tax and banking
18 system lacking transparency makes China a nonmarket
19 economy as you have already heard from numerous other
20 witnesses today. Our investigations indicate that
21 payroll taxes are subject to negotiation with
22 provincial or city authorities for locally controlled

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 businesses. In most cases, less than all employees of
2 the China-owned firms are counted in calculating the
3 tax. Foreign-owned or partially foreign-owned
4 factories, what few there are, have all of their
5 employees counted for tax purposes.

6 Additionally, China's value added tax on
7 exports is half that of the tax for domestically
8 produced products. This acts as a clear subsidy for
9 exports. Our members report that China's banking
10 system is far from transparent. Loans are not repaid
11 with impunity by some factories or loans are continued
12 without regard to the financial situation of the firm.

13 Seemingly, the number of workers employed is a key
14 determiner of the amount of loans granted, so it's the
15 way in which a market economy works. And
16 additionally, we believe that China's position
17 regarding its currency and its peg to the U.S. dollar
18 distorts the true prices of Chinese manufactured goods
19 within this country.

20 Fourth, China's continued resistance to
21 enforcing statutes on its books for intellectual
22 property theft is a major roadblock to a market

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 economy, we believe. One of our members reports it
2 had a patented knob including the imprinted patent
3 notice and its number copied precisely by a Chinese
4 firm and placed on goods destined for the United
5 States. Additionally, trade dress features and design
6 patents are routinely copied by China factories and
7 sold in the U.S. Almost every major branded cookware
8 designed in the United States has been precisely
9 copied at one time or the other by a China firm and
10 offered to the U.S. market sometimes at landed prices,
11 beneath the raw material inputs of an American
12 manufacturer.

13 Fifth and finally, China's continued
14 resistance to allowing direct sales of products to its
15 consumers marks it as a nonmarket economy. Several
16 members of the Cookware Manufacturers Association
17 produce product that is sold by distributors to direct
18 selling at home parties. In 2003, these firms
19 exported over \$50 million of U.S.-produced product to
20 the Far East, none to China. Despite assurances that
21 a sanctioned or accelling association would answer
22 China's concerns regarding fraud and direct sales,

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 China has continued to resist the free flow of goods
2 between and among its own citizens. This blocks
3 needed exports to China of a product with strong
4 demand in other Asian countries and that would help
5 balance China's overwhelming export position in the
6 United States.

7 We thank you for the opportunity to
8 comment and to testify today and I would be happy to
9 answer any questions that the Committee might have.

10 MR. JOCHUM: Thank you, Mr. Rushing. I'm
11 interested in some of the trade barriers to U.S.
12 exports that you identified, the permitting process,
13 the distribution system, the fact that intellectual
14 property is not protected and just out of curiosity,
15 how export oriented is the U.S. cookware business? Is
16 it a -- could you quantify the percent of exports as
17 total sales?

18 MR. RUSHING: Less than 10 percent.

19 MR. JOCHUM: And is China seen as a
20 potential significant market if some of these barriers
21 were removed? Is this something that your members are
22 targeting?

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 MR. RUSHING: We think so and particularly
2 those members that participate in the direct sale of
3 cookware manufactured in the United States. The "Made
4 in USA" cache surprisingly many people learn is very
5 valued in countries such as Japan, the Philippines,
6 Korea. USA made cookware there is seen to be on the
7 order of Cadillac automobiles and Calloway golf clubs,
8 I would say. So there is strong demand in the Far
9 East for this particular type of product and this
10 particular way in which the product is distributed.
11 Because it obviously has the ability to employ people
12 in a meaningful way and they can make meaningful
13 amounts of money and participate in the distribution
14 of this cookware.

15 MR. JOCHUM: Assume that the imports into
16 the U.S. of China product compete basically on price,
17 is that a fair statement? How would you evaluate in
18 terms of this, is this a lower end product or are they
19 competing across all sort of product ranges?

20 MR. RUSHING: That was where China got its
21 start. Five years ago, China was not even on the
22 radar screen. We do -- we prepare a report quarterly

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 which looks at the top five importers in 22 different
2 categories in which cookware and bakeware comes into
3 the United States. And five years ago China was not
4 even on the radar screen. They now, in 18 of those 22
5 categories, are by far the predominant producer. It
6 started in the lower priced goods, but China now has
7 the ability to manufacture any type, any quality level
8 of cookware that is needed or demanded by the U.S.
9 market.

10 MR. JOCHUM: Thanks. Any further
11 questions? Mr. Greenwood.

12 MR. GREENWOOD: Two questions. One had to
13 do with the issue of competing against state-owned
14 enterprises or recently privatized state-owned
15 enterprises. In your industry is this a large part of
16 the manufacturing base for cookware in China? Is it
17 mainly SOEs or former SOEs? First question.

18 MR. RUSHING: Our understanding is that
19 they previously have been state-owned factories that
20 were producing cookware items for the domestic market
21 in China that had been converted to export only firms
22 and have been privatized, if you will. In most cases,

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 the ownership transferred to local investors in a
2 particular province or a particular city. And the
3 permitting -- they go out of the domestic business, if
4 you will and go into the export business exclusively.

5 Cookware in China -- cookware is a fairly low tech
6 business. It doesn't take a huge amount of technical
7 expertise and engineering expertise to produce
8 cookware. And many factories that were stamping, they
9 were stamping woks and the conversion of that press
10 from a wok to a saucepan which would be popular in the
11 United States would be quite easily done.

12 In addition, we do know too of a number of
13 machine shops, obviously, that produced the dyes that
14 obviously stayed on and were transferred locally, in
15 very close proximity to the factories so they could
16 convert those particular factories to housewares
17 production.

18 MR. GREENWOOD: The second question,
19 directly related. You had mentioned the licensing
20 system, permitting system. You also mentioned the
21 incentives, both formal and informal that many of
22 these companies receive. Is it -- are these systems'

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 incentives and licensing decisions made at the local
2 provincial levels or are they central government
3 decisions or a mix? Do you have a sense of which
4 level or maybe even more levels, city kind of
5 regulations?

6 MR. RUSHING: I serve on the ITAC
7 Committee, ITAC 4, here at the Department of Commerce
8 and we hear a lot about the top brass, if you will, of
9 China's trade policy apparatus. But when I go back
10 and talk to my members who have been on the ground in
11 China, they tell me that it's almost never from
12 Beijing. It's always on the provincial and in many
13 cases a city level where they're having to do it. And
14 they can be told one thing in Beijing, but when they
15 get down to the particular province or they get down
16 to the particular city, they find that there's again,
17 if the central government, the one way in which it's a
18 command economy, apparently is not always with
19 policies being issued from Beijing and provincial and
20 city governments falling into line. Many of them
21 appear to be operating wholly outside the pale, if you
22 will, of what the central government may have directed

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 them.

2 I think this is particularly true in the
3 IPC question as well. By the time you could get -- if
4 you could get a hearing and could get enforcement of a
5 judgment, it's by far way too late, way too late.

6 MR. JOCHUM: Ms. White.

7 MS. WHITE: Thank you. My ears lit up, so
8 to speak, when you said that employment -- I'm from
9 the Labor Department -- employment in the United
10 States had decreased by 30 percent. To what extent
11 does the competition with Chinese brands affect your
12 industry versus is there some -- I've learned in other
13 contexts that some of the cookware manufacturers fill
14 in their product lines with goods or pots or frying
15 pans or something from other countries. To what
16 extent does your industry make use of Chinese
17 sourcing?

18 MR. RUSHING: Probably more than half of
19 our membership is really forced by the marketplace and
20 the demands of the marketplace, 40 percent, over 40
21 percent of the cookware that's sold in this country is
22 retailed by what we know in the industry as mass

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 merchants, the Wal-Mart's, the KMart's, the Target's.
2 They have certain price points that they demand
3 manufacturers to produce product at if they are buying
4 a branded product. And many manufacturers have been
5 forced, in some cases almost wholly, to source those
6 products out of China now. If not, there's very
7 active, direct selling, if you will, directly from
8 Chinese agents in the United States that can supply
9 those particular products. They wouldn't necessarily
10 be branded, but they would look just like the brand,
11 branded product would look. We've had -- last year,
12 large factory, Merrill Factory in Manitowak, Wisconsin
13 completely closed down including an aluminum rolling
14 mill. Their employment had been reduced for a number
15 of years and it just got to where they couldn't
16 compete they said. So all of that product is now
17 sourced out.

18 MR. JOCHUM: Terry?

19 MR. McCARTIN: You expressed concerns
20 about wholesale and resale distribution in China and
21 also about direct selling. I would just note for you,
22 you may be aware, in April, China issued regulations

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 that called for the opening up of wholesale and resale
2 distribution by the end of the year and they've also
3 indicated that in the coming months they'll be issuing
4 regulations on direct selling and there they have a
5 commitment by the end of the year to open up that
6 sector as well.

7 We would just be interested in any
8 feedback you have for us just exactly how that system
9 is operating once it's up.

10 MR. RUSHING: We'll do that. I know our
11 members who are involved in that are very hopeful that
12 that trickles down, if you will, to the local level in
13 addition to being on the paper at the top level as
14 well. And we'll do that, keep you informed.

15 MR. LORENTZEN: Mr. Rushing, I was
16 interested in the information you had to share under
17 your first item regarding subsidies and incentives to
18 enterprises transitioning from state ownership and I
19 guess if you have any more specific information on
20 those practices, for example, whether they are
21 targeted to cookware manufacturers, specifically do
22 they tend to come from local government as opposed to

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 central authorities? Any information along those
2 lines?

3 MR. RUSHING: I'll be happy to supply
4 that. I'll do some more investigation. My just brief
5 understanding of that, it is in most cases on the
6 local level, city or provincial level, where there was
7 a previously state-owned factory in some sort of metal
8 bending business and the process of transferring that
9 over to private ownership and in some cases the
10 permitting process didn't change, but I'll try to get
11 you some specifics on that as well.

12 MR. JOCHUM: Mr. Rushing, thanks very much
13 for your interesting testimony. We appreciate you
14 coming up here and participating.

15 Next we will hear from the American Forest
16 and Paper Association.

17 Hi, how are you.

18 MS. RUBLOWSKI: Hello. I'm Anne
19 Rublowski, Vice President International of the
20 American Forest and Paper Association. I appreciate
21 this opportunity to present the Forest and Paper
22 Products Industry's views on issues pertaining to

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 Chinese government market-distorting policies and
2 practices. The American Forest and Paper Association
3 is the national trade association of the forest, pulp,
4 paper, paperboard and wood products industry. AF&PA
5 was a strong supporter of permanent, normal trade
6 relations with China and China's accession to the WTO.

7 Our industry support was based on the
8 prospect that China's rapid economic growth would
9 generate strong demand for U.S. exports of paper and
10 wood products. At the same time, we recognized that
11 the expectation of market opportunities could only be
12 achieved if China implements commitments to open up
13 its market and remove trade barriers, commitments
14 which were conditioned of its accession to the WTO.

15 While China has made some progress toward
16 becoming a market economy, the Chinese government
17 continues to employ an array of industrial policy
18 tools. These actions are intended to promote the
19 rapid expansion of China's paper and wood processing
20 industry. The result has been the substantial drop in
21 market opportunities for U.S. manufacturers. This is
22 particularly troubling since China doesn't have the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 large fiber resources necessary for domestic forest
2 products industry and is almost wholly dependent on
3 imported fiber in the form of logs and other wood
4 products with pulp and recovered paper.

5 AF&PA and its members are increasingly
6 concerned about government subsidization of the forest
7 products industry in China. In an effort to catalogue
8 these practices AF&PA spent six months studying the
9 Chinese industry. Our 100 page report, "China's
10 Subsidization of Its Forest Products Industry" will be
11 released later this month. I brought with me today an
12 excerpt which is available up on the shelf and which I
13 think some of you have as well and I would ask that it
14 be appended to my oral testimony.

15 The report outlines several nonmarket
16 practices that have led to the build up of the Chinese
17 paper and wood processing industry. A few examples:
18 between 1998 and 2002, the Ministry of Finance
19 provided \$1.67 billion in loan interest subsidies for
20 technology renovations of 21 state-owned paper mills.

21 The Ministry of Finance has designated \$1.73 billion
22 for the development of fast growth, high yield

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 plantations by 2015. Policy banks such as the China
2 Development Bank and the Agriculture Bank of China are
3 providing companies in the forest products sector with
4 low interest loans or loans with unusually long
5 repayment terms.

6 At the provincial and municipal levels,
7 banks are engaged in nonstandard lending and other
8 practices to attract foreign investment including debt
9 forgiveness and debt for equity swaps, extended loan
10 repayment terms and preferential loan interest rates.

11 Our members will gladly compete against
12 any forest products industry in the world. In China,
13 we are up against an industry propped up by a
14 seemingly unlimited government sponsored cash drawer.

15 We think such practices are not the hallmark of the
16 market-driven economy.

17 The convertibility of the China Yuan or a
18 lack of it, is another important issue when
19 considering whether China is a market economy.
20 China's currency is not freely convertible and the
21 government has kept the Yuan pegged to the dollar at
22 an artificially low rate for a decade. Taking into

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 account China's economic growth, overall trade
2 surpluses over the past decade and the large inflow of
3 foreign direct investment, it is clear that the Yuan
4 is significantly undervalued to the detriment of
5 China's trading partners.

6 The undervalued Chinese currency has
7 undermined our industry's ability to compete in the
8 Chinese market. When the undervalued currency is
9 combined with targeted government financing, the
10 result is such a substantial build up of Chinese
11 production and capacity and growing Chinese exports.
12 The Chinese forest product industry is artificially
13 competitive.

14 U.S. imports of paper and paperboard
15 products from China jumped to \$1.04 billion last year
16 from \$635 million two years earlier. While U.S. paper
17 and paperboard exports to China also rose during this
18 period, they only reached \$438 million last year, up
19 from \$328 million in 2001. China has also become a
20 large exporter of wood products.

21 AF&PA urges the Administration to
22 carefully examine how exchange rates impact market

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 access opportunities in China. The issue should be a
2 major part of the agenda of the U.S.-China Joint
3 Commission on Commerce and Trade.

4 There are two other issues that I'd like
5 to just mention briefly. We've received reports that
6 the China value added tax has not been applied equally
7 to domestic products and to all imports. Moreover, in
8 some Chinese jurisdictions, that is not applied to
9 domestic products, giving them a competitive
10 advantage. Chinese central authorities must ensure
11 uniform, nondiscriminatory method for collecting and
12 reporting the collection of the VAT.

13 Of special concern to our industry is the
14 amount of illegally harvested timber that is believed
15 to be entering China, particularly from the border
16 areas of Burma and Russia. Illegal logging undermines
17 public acceptance of legally harvested and traded
18 forest products. U.S. trade opportunities in China
19 are directly affected by the abundance of inexpensive,
20 illegally harvested timber flowing into China.
21 Progress is being made in shutting down smuggling
22 operations, but we remain concern still about the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 presence of illegally logged wood in the marketplace.

2 In conclusion, AF&PA believes that China
3 has a long way to go in addressing its economic and
4 trade distorting policies and practices before it can
5 be considered a market economy. The Administration
6 should address the critical issues of subsidies,
7 currency manipulation, VAT treatment and illegal
8 logging in the upcoming discussions with the Chinese
9 government.

10 Again, I appreciate this opportunity to
11 provide comments on these issues and we look forward
12 to answering any questions you have.

13 MR. JOCHUM: Thank you, Ms. Rublowski. I
14 was interested in the written testimony, the
15 discussion about Chinese use of their anti-dumping
16 laws and I think you know that part of my agency's
17 role is to actually help U.S. exports who face dumping
18 actions from foreign governments and we also wear the
19 hat of being the negotiator at the Rules Committee at
20 the WTO, so I'd be very interested in any experience
21 you can share with us, maybe even privately in terms
22 of your thoughts of how your company was treated in

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 that process and whether perhaps WTO commitments were
2 abridged because I think the statement was made that
3 they're using it to maybe unfairly protect their
4 domestic industry or to give them some sort of
5 competitive advantage. And if they're going beyond
6 the limits that the WTO places on the use of the
7 dumping laws, we'd be very interested in that type of
8 information.

9 MS. RUBLOWSKI: Thank you. I will say
10 that while reference is made to the anti-dumping, I
11 guess you'd call it predatory anti-dumping, in the
12 short paper that I've given you, the larger report has
13 the more full discussion that obviously we'd like to
14 come in and share with you.

15 As you know, on March 31st the Chinese
16 filed an anti-dumping petition against U.S.
17 manufacturers as well as Taiwanese, Korean and Thai
18 manufacturers of a certain kind of craft liner board
19 and AF&PA is coordinating the injuries side of that
20 for the industry. And I think once we get a little
21 bit farther along in our work we'd very much like to
22 come in and talk to you about that.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 MR. JOCHUM: Further questions? Ron, go
2 ahead.

3 MR. LORENTZEN: I guess one thing that I
4 might be a little bit -- I'd be interested in hearing
5 a little bit more on which has to do with the
6 evolution of the government's role in the economy in
7 China and the sense that I kind of get from your
8 written submission is that part of the problem is
9 actually devolving certain responsibilities to the
10 local level where perhaps factors of corruption or
11 cronyism or whatever or at least favoring the local
12 champion, if not the national champion factor in.

13 Is there anything more that you can say on
14 that score and to what extent is this focus at the
15 local subcentral level, something that we need to
16 really pay attention to in the discussions in our
17 Working Group as that proceeds?

18 MS. RUBLOWSKI: I mean what the report
19 shows us and there's a lot of anecdotal information,
20 but what the report speaks to is that in terms of
21 lending practices at the regional and provincial
22 level, it seems that the farther down that you go, the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 looser, if I can apply that term, the looser the
2 requirements for paying back the loan, the looser the
3 interest requirements, the looser the terms. And
4 that's something that we have been able to document.
5 And I think that we'd be happy to sit down and have a
6 larger discussion of those kinds of practices. I
7 realize I'm not the only person who's made that point.
8 But it does seem that the farther down you go in the
9 chain, the looser the activity in our sector.

10 MR. MAY: I was just curious. If I
11 understood your presentation correctly, you referred
12 to preferential loans to the industry in China. And I
13 was just a bit curious as to how you determine the
14 degree of preferentiality. Do you just mean that this
15 sector received loans at lower rates than other
16 sectors or did you have some sort of commercial
17 benchmark against which you measured the degree of
18 preferentiality?

19 MS. RUBLOWSKI: We didn't compare it
20 sector to sector. We looked instead at the loans, the
21 loan terms, I guess you would say versus what would be
22 commercially available in the market.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 There is also, there are no U.S.-based
2 forest products companies who are making or
3 processing, manufacturing in China. There are
4 European companies, Korean companies, Japanese
5 companies and it doesn't look to us as though those
6 companies have received this kind of preferential
7 treatment. It appears to be the state-owned
8 enterprises who are getting loans at less than what
9 you or I would consider to be prevailing rates.

10 MS. KOEPKE: Thank you. I just wanted to
11 ask one question with specific regard to the
12 convertibility question of the currency and I think we
13 agree that there are controls in place that are
14 probably more heavily weighted towards controls on
15 outflows of funds from China. And I was curious as
16 the Treasury engages with the Chinese government on a
17 couple of different levels, both senior officials, as
18 well as that working level. What controls that are in
19 place today you would strongly support we work with
20 with the Chinese to try and liberalize or to lift some
21 of those controls that prevent full convertibility of
22 the currency for purposes of the financial

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 transactions and the capital account?

2 MS. RUBLOWSKI: I don't know that I can
3 give you a precise answer. I'd like to get back to
4 you, but I know that the concern that our members have
5 expressed is on the issue of really the valuation and
6 the inability they have competing against -- I mean
7 there's a -- and I hear it frequently that you can
8 overnight wipe out all of the good that you've done in
9 a tariff negotiation or an NTB negotiation with
10 currency shift. And our members are focused on sort
11 of the valuation effort. We haven't looked at the
12 controls issue, but that's something that we'd be
13 happy to take a look at.

14 MR. JOCHUM: Thank you, Anne. I
15 appreciate your participation today.

16 The final slot of the day is reserved for
17 the AFL-CIO. Thank you for joining us.

18 MS. DRAKE: Thank you very much, Mr.
19 Chairman. My name is Elizabeth Drake and I'm an
20 international policy analyst with the AFL-CIO today
21 here representing 13 million workers in more than 60
22 unions that are members of the AFL-CIO. We certainly

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 appreciate this opportunity to testify on China's
2 interest in being designated as a market economy.

3 Our members have an urgent interest in
4 ensuring that U.S. trade policy with China is fair and
5 equitable, given the large and growing U.S. bilateral
6 trade deficit with China, the continued egregious
7 abuses of workers' human rights in China, and the loss
8 of millions of American manufacturing jobs over the
9 past two years.

10 We believe that it is premature to begin
11 negotiating market economy status with China at this
12 time. China clearly fails a number of key criteria
13 for market economy status as has been detailed by many
14 of the other witnesses. And China does not come close
15 to the standards established from market economy
16 status in our law.

17 At a time when our government has been
18 hesitant or sometimes outright refused to use the
19 legal tools that already exist at the WTO and in our
20 domestic trade law to secure compliance with basic
21 standards on workers rights and trade, we believe it
22 is particularly in appropriate to consider granting

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 China even more beneficial trade treatment in an
2 attempt to gain improvements in these areas.

3 The U.S. government and many different
4 agencies have repeatedly identified a broad array of
5 areas in which China does not live up to its
6 international obligations and yet we've continued to
7 grant China exactly the same market access as many
8 other developing countries that are playing by the
9 rules. This is not fair to other countries and it is
10 not fair to American workers and producers.

11 We at the AFL-CIO believe that we must use
12 all of our diplomatic, economic and political leverage
13 to ensure that China respects the rules of a multi-
14 lateral system, including trade rules and rules on
15 workers' rights and human rights. And until the
16 Chinese government can demonstrate convincingly that
17 it is abiding by these rules, that we should not
18 consider granting new benefits through the market
19 economy status designation.

20 I wanted to focus my comments on two of
21 the criteria, specifically the currency convertibility
22 criteria and the workers' rights criteria. I think

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 that many other witnesses have spoken about the
2 currency convertibility and I just want to echo those
3 concerns on behalf of the AFL-CIO. We agree that
4 China is undervaluing its currency by at least 40
5 percent. Some have estimated this under valuation as
6 high as 75 percent and we believe this currency
7 misalignment, this magnitude has enormous significance
8 in the context of U.S.-China trade and it's distorting
9 our trade relationship with that country and we
10 believe that before even considering granting market
11 economy status, the Chinese government must undertake
12 a major revaluation of its currency on the order of 40
13 percent and take significant steps towards removing
14 currency restrictions to allow its currency to reflect
15 market values.

16 On the issue of workers' rights, wages in
17 China are not determined by free bargaining between
18 labor and management because workers are prevented by
19 law from forming independent unions and prevented from
20 exercising the right to strike. Workers who are
21 unable to exercise these rights are relegated to
22 accepting the wages that their employers offer and

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 these wages far fall below those paid in other
2 countries at comparable levels of development. Free
3 bargaining cannot exist when the fundamental tools for
4 worker bargaining, the right to freely associate into
5 independent unions, the right for such unions to
6 bargain collectively with employers, the right to
7 speak out publicly about labor abuses and the right to
8 strike are routinely suppressed by the government in a
9 comprehensive, unremitting and brutal manner.

10 Many of these abuses are detailed in the
11 recent Section 301 petition that we filed on workers'
12 rights abuses in China and I encourage everyone who
13 hasn't had a chance to look at that petition to do so
14 to get more of a flavor of some of the details of
15 these abuses that routinely occur.

16 Our petition estimates that this
17 illegitimate suppression of workers' rights
18 artificially reduces wages in China by 47 to 86
19 percent and that this artificial reduction in wages
20 creates an unfair cost advantage for Chinese goods in
21 our market of about 43 percent. This unfair cost
22 advantage, in turn, displaces up to 700,000 U.S. jobs.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Now some have criticized these estimates
2 as being excessive, but I think it's interesting when
3 you look at our estimate of the amount by which wages
4 are artificially suppressed in China due to workers'
5 rights violations and if you look at the way that fair
6 market value has been imputed in anti-dumping
7 investigations in trying impute wages, there's
8 actually a fair amount of agreement.

9 In our petition, we cite some studies
10 showing that manufacturing wages in China can be as
11 little as 15 to 30 cents an hour and yet the imputed
12 wage in the fair market value is 90 cents an hour.
13 That's three to six times as much, not very far from
14 what we actually estimate in our petition. So I think
15 that we need to actually look at that petition
16 seriously in terms of estimating what is the actual
17 result of labor rights suppression in terms of wages
18 in China and as proof of the failure of free
19 bargaining and the lack of existence of free
20 bargaining.

21 I want to talk briefly about the right to
22 strike in China and then focus mostly on freedom of

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 association and the right to bargain collectively.

2 There is no right to strike in China at
3 all. China's tribunal and law requires that all China
4 Federation of Trade Unions to mobilize workers to
5 complete their production duties and to suppress
6 strikes. Unless workers are free to withhold their
7 labor through strike action, they have little leverage
8 to bargain freely over wages. Those who disturb the
9 order of production of work, risk internment and re-
10 education through labor camps in China. The security
11 forces and the army, also controlled by the Central
12 Communist Party, violently crush labor stoppages and
13 protests. They assault or detain workers who
14 participate in those activities and also their spouses
15 and children. Even journalists who report on the
16 activities are beaten and harassed by public security
17 forces in the hope of erasing the protests from public
18 memory.

19 Chinese law also prohibits workers from
20 organizing independently of the All China Federation
21 of Trade Unions. The ACFTU is subordinate to and
22 legally required to obey the bureaucracy of the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 Chinese Communist Party. Its activities are also
2 quite often controlled and interfered with by
3 management in export industries. Managers serve as
4 union officials. Managers select union officers and
5 managers control union finances. All of these are
6 flagrant violations of international principles of
7 freedom of association.

8 Workers who do attempt to organize
9 independent unions or participate in public protests
10 are severely repressed. During the Tianenman Square
11 protest which were almost exactly 15 years ago,
12 Chinese workers in several cities organized the
13 workers of autonomous federations in opposition to the
14 ACFTU. It was the mounting participation of these
15 autonomous worker organizations in the pro-democracy
16 demonstrations that was the significant factor in the
17 Communist Party's decision to unleash the army on the
18 protesters.

19 Since 1989, there have been many other
20 attempts to organize independent worker organizations
21 in China and all of these have been suppressed with
22 machine gun fire, beatings, police harassment, forced

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 labor, forced relocation to impoverished regions,
2 detention without trial, psychiatric internment,
3 forced electroshock treatment, forced medication,
4 false criminal charges, show trials and long term
5 imprisonments. This tragically has been documented at
6 great length by the ILO, the U.S. government and
7 respected independent human rights organizations.

8 The weapons of state terror are directed
9 at rank and file workers, worker leaders, worker
10 spouses and children, journalists reporting the
11 protests and lawyers providing counsel to the workers.

12 I think we can all agree that this is a picture that
13 is very far from the picture of a market economy.

14 In sum, factory workers in China are
15 wholly denied the fundamental rights of association
16 and collective bargaining, both by law and by
17 practice. Either the monopolistic ACFTU is present in
18 an enterprise, or there's no union at all. Where the
19 ACFTU is present, its role is to discipline the work
20 force in line with party policies, local development
21 strategies and investor goals, not to assert worker
22 rights and not to bargain freely for fair wages for

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 those workers.

2 Strikes are illegal in China and the ACFTU
3 is charged with the task of suppressing them. While
4 there may be dissidents within the ACFTU who are
5 worthy of support, they are overwhelmed by the party's
6 stringent control. When workers protest or associate
7 outside the constraints of the ACTFU, they enter a
8 whirlwind of state terror, of torture, beatings,
9 forced labor and long-term imprisonment.

10 The AFL-CIO believes that before the U.S.
11 government considers granting market economy status,
12 fundamental and extensively reforms must take place to
13 ensure that core workers' rights enshrined in the ILO
14 declaration on fundamental principles and rights are
15 respected in law and in practice in China. Most
16 fundamentally, workers must have the right to form
17 unions independent of their government and employers.

18 They must have the right to organize, bargain
19 collectively and strike without fear of imprisonment
20 or physical attack. Anything less would make it
21 impossible to freely bargain for wages in China and to
22 be considered as a market economy.

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 Thank you.

2 MR. JOCHUM: Thank you for your testimony.

3 And we will take a look at the information you
4 submitted as part of your petition. I thought it was
5 interesting the comparison you made to what we do here
6 at the Department under the dumping laws. I think
7 that's a relevant consideration.

8 Questions from the panel?

9 Ms. White.

10 MS. WHITE: Thank you very much. I was
11 wondering if you could differentiate at all between
12 you stressed the lack of independent trade unions and
13 all the various means of suppression of such. And to
14 what extent do you think, assuming it were at all
15 possible, that there were a movement towards allowing
16 free trade unions, that this would -- I assume it
17 would increase the degree of free collective or free
18 bargaining which is part of the criteria we're talking
19 about.

20 Do you have sort of a way that this would
21 happen and to what degree, what stage, and what other
22 factors are there in the Chinese labor system, if you

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 will, that would also need to be corrected, even if
2 there were free collective bargaining or free
3 bargaining?

4 MS. DRAKE: That's a very good question.
5 I think obviously the transition from the current
6 system to a system of respect for independent unions
7 is going to be a very difficult transition for China,
8 not just economically, but politically. We understand
9 that. We realize it's not something that can happen
10 over night, but there are, I think, a number of
11 different ways in which allowing independent unions
12 would have a direct effect on wages. And in the
13 petition we look both at the union threat effect,
14 which is the effect that comes just from employers
15 knowing that their workers may have the right to join
16 a union, even if those workers themselves are not
17 unionized.

18 And then there's the direct union wage
19 effect of workers actually being organized into an
20 independent union that's able to bargain on its behalf
21 with its employer over wages. And there are a number
22 of specific numbers we attribute to both of those

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 effects in the petition, looking at some research
2 that's been done both in developed and developing
3 countries, looking at two different wage impacts that
4 come from freedom of association.

5 Other factors are also important to
6 consider because even if workers are allowed to
7 organize into independent unions, there are other
8 factors that suppress their rights and suppress wages
9 in China. And one we look at specifically is the
10 internal pass system in China and I understand that
11 there have been some recent reforms implemented and
12 proposed that system, but it still allows a great
13 degree of control over internal migrants within China
14 and restricts to some extent the ability of those
15 workers to move from one employer to another. So when
16 you do not have voice as a union, as a union member,
17 another way to influence your wages is exit, to leave,
18 and to go to a different employer when those rights
19 are restricted. It clearly restricts the ability of
20 wages to rise and workers to bargain up their wages.

21 Also, the continued permission or
22 allowance on the part of the Chinese government of

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 forced labor in the prison system and of child labor,
2 both work to lower wages in China. The extent of that
3 is a little harder to quantify and we don't work hard
4 to do that in our petition.

5 Finally, there's the inability or refusal
6 of the Chinese government to enforce minimum wage and
7 hour standards and health and safety standards and
8 health and safety standards. And this is a serious
9 problem, especially the standards on hours, on working
10 hours where we have a lot of forced over time that we
11 see in Chinese factories. So often the reported wages
12 are, in fact, much lower if you look at the hours that
13 workers are working. So those are some of the other
14 factors that we think we should have to look at if
15 we're trying to figure out whether or not there's true
16 free bargaining in China and that workers' rights are
17 being respected.

18 MR. JOCHUM: Jim?

19 MR. LEONARD: I am Jim Leonard with the
20 Office of Textiles and we have actually a pretty good
21 working relationship with our Chinese counterparts and
22 we've had a number of discussions with them in recent

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 months about when quotas go away at the end of this
2 year, there's an expectation that the significant
3 surge of imports of textiles and apparel products from
4 China. And we've had a number of discussions with
5 them about well, we don't really have any leverage to
6 require them to do anything. We try to make the point
7 that there's certainly an advantage to them to try to
8 control their exports because in the absence of some
9 sort of mechanism to prevent surges, we do have the
10 ability under the WTO accession for China to put
11 individual quotas back in place on individual
12 products, assuming we can prove market disruption.

13 That creates a situation where U.S. buyers
14 may become a little hesitant to place a big order on
15 women's dresses, for example, if there's a probability
16 they won't be able to get that product in. So we
17 continue to have this discussion with the Chinese
18 without very much progress, I might add.

19 But one of the points that they continue
20 making to us is you don't understand, we have to
21 employ X thousand new workers a month or a week and
22 we've got 1.2, 1.4 billion people. We have to employ

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 them. So having said all of that, do the Chinese,
2 absent -- I'm not talking about some of the illegal
3 labor, the prison, the child and that sort of thing,
4 but what incentive is there for them to allow unions
5 and to allow free association when they have an almost
6 unlimited supply of people that are willing to work
7 for these wages under those conditions?

8 MS. DRAKE: Well, that's a very good
9 question and I mean part of it, in some ways those
10 workers don't really have a choice. Of course, they
11 are working under those conditions because if they
12 press for different conditions, they are put in jail.

13 But you know, China really does have a
14 choice to make about what its development strategy is
15 going to be over the next few decades and right now it
16 seems like a large part of its development strategy is
17 to depend upon the U.S. market remaining open and we
18 think that is a very risky strategy because there is
19 this unpredictability and ultimately it's
20 unsustainable. We simply can't sustain the current
21 trade deficit that we have here in the United States
22 and to have every other country in the world depending

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 on that access, I think is a very risky strategy both
2 for the individual countries, but for the global
3 economy as a whole.

4 Now I do think that in the long term it is
5 in China's economic interest to grant workers' rights
6 and respect workers' rights. Unless China's workers
7 are able to earn a fair share of the wealth that they
8 produce, China will never be able to build a real
9 middle class and that's the only way it's ultimately
10 going to develop is if it's developing its own
11 internal market, rather than depending on access to
12 foreign markets as its only way to continue producing.

13 And I think that it will be a painful transition, but
14 it's a necessary transition and unless workers are
15 able to organize into unions and bargain as they were
16 here in the United States which helped build the
17 middle class of the United States, build a very robust
18 internal market in the United States that's really the
19 envy of the world, and I think that's what China needs
20 to do if it wants to develop.

21 I think that really the main reason that
22 it resists are political reasons. I think that the

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 economic evidence looking at other countries, looking
2 at the impact of freedom of association and unions on
3 economic development all favor allowing workers to
4 organize. I think that it's really a political
5 consideration in terms of not wanting to allow any
6 independent source of political power within the
7 country.

8 MR. JOCHUM: Thank you for your testimony
9 today and I had a follow-up question that was prompted
10 by the voluminous indicators that you provided us as
11 well as a couple of them that went to the question of
12 looking at the experiences of developed versus
13 developing countries.

14 As you know, in a number of contexts, but
15 most particularly in trade contexts, China has claimed
16 status as a developing country and wants to be
17 recognized as such. In this particular context that
18 we're dealing with here, the question is market versus
19 nonmarket. And I was wondering whether even if it's
20 only in general terms, you would be able to draw some
21 lines for us between the assessment of the Chinese
22 labor standard and wage rate experience between a

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 nonmarket setting and a developing country setting.
2 In other words, what indicators reflect its nonmarket
3 character as opposed to an allegedly developing
4 country?

5 MS. DRAKE: I think certainly it's very
6 common for developing countries to have a large
7 reserve of unemployed workers which in and of itself
8 drives down wages to have difficulty enforcing wage
9 and hour standards or child labor standards. I think
10 that's very common, but I think what you see in China
11 that really distinguishes it as a nonmarket economy is
12 a conscious, political strategy and explicit legal
13 framework that forbids workers from organizing and
14 bargaining collectively with their employers through
15 independent unions. And that is not unique, but very
16 rare.

17 If you look at other large developing
18 countries, India, Brazil, South Africa, they have
19 independent unions. They also have a lot of
20 unemployment. They also have difficulty enforcing some
21 of their labor laws, but they do not forbid workers
22 from organizing independent unions. And to us, that

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

(202) 234-4433

www.nealrgross.com

1 is the true key distinction between China and other
2 comparable developing countries and really what marks
3 it as a nonmarket economy that its workers are simply
4 forbidden from joining together and bargaining with
5 their employers. That's a crucial distinction.

6 And the International Labor Organization
7 in laying out the core labor standards makes very
8 clear and very explicit that the freedom of
9 association, the right to organize and bargain
10 collectively are fundamental human rights of workers
11 that must be respected, regardless of the economic
12 situation in which that worker's country may find
13 itself and that they can be respected, regardless of
14 that situation. So these are qualitative human
15 rights, not quantitative standards that depend upon a
16 level of development.

17 MR. JOCHUM: More questions? Sure.

18 MS. KOEPKE: I wonder if I could just pose
19 the same question I posed earlier because I recognize
20 your recommendation for China to take steps for
21 liberalizing its capital controls which is a separate
22 issue from sort of the exchange rate regime

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 specifically. So I was wondering if you could comment
2 on what recommendations specifically that -- or what
3 measures that ought to be lifted in order to sort of
4 achieve a greater convertibility of the capital
5 account. Same question.

6 MS. DRAKE: I'm afraid I'm not at all an
7 expert on that issue, but I will certainly go back and
8 ask our people what measures that they would recommend
9 and get back to you. We have focused specifically on
10 the valuation and pushing for the revaluation and
11 that's been our primary goal, but we are interested in
12 the other restrictions as well, and so I'll have to
13 defer and get back to you.

14 MS. KOEPKE: That would be very helpful.
15 Thanks.

16 MR. JOCHUM: Thank you for your excellent
17 testimony. I appreciate it.

18 MS. DRAKE: Thank you.

19 MR. JOCHUM: Well, that brings us to the
20 end. I just wanted to thank everyone for
21 participating. I know I speak for all of us up here
22 in saying that it was extremely helpful in organizing

NEAL R. GROSS

COURT REPORTERS AND TRANSCRIBERS

1323 RHODE ISLAND AVE., N.W.

WASHINGTON, D.C. 20005-3701

1 our work for the Structural Working Group as well
2 proceed and I hope to continue the dialogue with all
3 of you and with that, unless there are closing
4 statements among our panelists, I think people are
5 more hungry than interested in making statements,
6 we'll adjourn. Thanks very much.

7 (Whereupon, at 1:17 p.m., the public
8 hearing was concluded.)

9
10
11
12
13
14
15
16
17
18
19
20
21
22